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LEGAL ANALYSIS

(Prepared by the UNIDROIT Secretariat)

Introduction

1. The purpose of this document is to set out the main legal and technical issues related to the draft Protocol to the Convention on International Interests on Mobile Equipment on Matters specific to Mining, Agricultural and Construction Equipment (“the draft MAC Protocol”). The document is the result of research conducted by the Secretariat, deliberations of the Study Group across its four meetings and decisions made by the Committee of Governmental Experts (“the Committee”) during its first (“CGE1”, Rome, 20–24 March 2017) and second (“CGE2”, Rome, 2–6 October 2017) sessions, as well as consultations undertaken in 2018 and 2019 with States, experts and the private sector.

2. This document does not attempt to address every possible legal question that could arise in connection with the draft MAC Protocol. Instead, it focuses on the main issues that arose in three contexts:

- (1) Issues associated with adapting the rules of the Convention on International Interests in Mobile Equipment (the “Cape Town Convention” or “the Convention”) to create an appropriate framework for the financing of mining, agricultural and construction (“MAC”) equipment (for example, limiting the application of the MAC Protocol its application to equipment that satisfy Article 51(1) of the Convention; high value, mobile and uniquely identifiable).
- (2) Issues that are not addressed in the existing Protocols to the Cape Town Convention due to the nature and use of MAC equipment itself (such as the relationship between MAC equipment and immovable property).
- (3) Issues related to the specific financing practices for equipment used in the MAC sectors (such as the financing of MAC equipment held as inventory by dealers).

3. The document is similar in structure to the legal analysis documents developed throughout the MAC Protocol project.¹ Issues are grouped together under six thematic sections:

- (1) Issues related to the Cape Town Convention
- (2) Issues related to scope
- (3) Issues related to association of MAC equipment with other assets
- (4) Issues related to insolvency and enforcement
- (5) Issues related to registration
- (6) Other issues

4. Issues that generated significant discussion or debate by experts and States during negotiations are considered in detail (for example, the use of the Harmonized Commodity and Coding System to define the scope of the MAC Protocol). The Secretariat has also prepared additional analysis on issues that were not fully resolved by the Committee of Governmental Experts on 2017. In particular, Parts 2H (treatment of inventory), 3I (association with immovable property), 3J (accessions/parts), 6R (administrative authorities) and 6X (amendment procedures) have been expanded to reflect further analysis and consultations undertaken in 2018 and 2019. The appendices to this document contain research papers produced by the Secretariat and organisations involved in the project between 2014 – 2019 to provide further analysis on complex legal issues. Several appendices contain comparative jurisdictional analyses that discuss how different domestic legal systems address certain issues.

5. This document is designed to be considered in conjunction with the Explanatory Report to the draft MAC Protocol (UNIDROIT 2019 – DCME-MAC – Doc. 4) which provides an article-by-article analysis of the draft instrument, the Harmonized System code analysis (UNIDROIT 2019 – DCME-MAC – Doc. 6) which provides analysis on the HS codes listed in the draft MAC Protocol Annexes and how they were selected and the introduction to the Cape Town Convention (UNIDROIT 2019 – DCME-MAC – Doc. 7).²

6. References in this document to the “draft MAC Protocol” are references to DCME-MAC – Doc. 3³ as approved by the Committee at CGE2. References to the “preliminary draft MAC Protocol” are references to the earlier draft texts reviewed by the Committee during both of its sessions.⁴ During the Study Group sessions, the Study Group developed six iterations of the draft text. Previous drafts of the text developed during the Study Group sessions are referred to in this paper as “Study Group draft”.⁵

¹ See <https://www.unidroit.org/english/documents/2014/study72k/s-72k-sq01-02-e.pdf>; <https://www.unidroit.org/english/documents/2015/study72k/sq02/s-72k-sq02-04-e.pdf>; <https://www.unidroit.org/english/documents/2015/study72k/sq03/s-72k-sq03-02-e.pdf>; <https://www.unidroit.org/english/documents/2016/study72k/s-72k-sq04-02-e.pdf>; <https://www.unidroit.org/english/documents/2016/study72k/cge1/s-72k-cge01-04-e.pdf>; <https://www.unidroit.org/english/documents/2017/study72k/cge02/s-72k-cge02-04-e.pdf>.

² UNIDROIT 2019 – DCME-MAC – Doc. 7 is forthcoming (September 2019).

³ <https://www.unidroit.org/english/documents/2018/study72k/dc/s-72k-dc-03-e.pdf>.

⁴ [UNIDROIT 2017 – Study 72K – CGE1 – Doc. 2 corr](https://www.unidroit.org/english/documents/2017/study72k/cge1/s-72k-cge01-04-e.pdf); [UNIDROIT 2017 – Study 72K – CGE2 – Doc. 2](https://www.unidroit.org/english/documents/2017/study72k/cge2/s-72k-cge02-04-e.pdf).

⁵ See <https://www.unidroit.org/english/documents/2014/study72k/s-72k-sq01-03-e.pdf>, <https://www.unidroit.org/english/documents/2015/study72k/sq02/s-72k-sq02-05-e.pdf>, <https://www.unidroit.org/english/documents/2015/study72k/sq02/s-72k-sq02-07-e.pdf>, <https://www.unidroit.org/english/documents/2015/study72k/sq03/s-72k-sq03-03-e.pdf>, <https://www.unidroit.org/english/documents/2016/study72k/s-72k-sq04-03-e.pdf>, <https://www.unidroit.org/english/documents/2016/study72k/s-72k-sq04-06-e.pdf>.

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PART 1 – THE CAPE TOWN CONVENTION

A. Relationship between the Cape Town Convention and MAC Protocol

7. The MAC Protocol will not be a stand-alone international treaty. It will be the fourth Protocol to the *Convention on International Interests in Mobile Equipment*, concluded in Cape Town on 16 November 2001 (the “Cape Town Convention” or “Convention”). The purpose of the Cape Town Convention is to provide a stable international legal regime for the protection of secured creditors, conditional sellers and lessors of certain categories of objects through a set of default remedies and the protection of creditors’ interests by registration in an International Registry, thus securing priority and protection in the event of the debtor’s insolvency.⁶ The Cape Town Convention has 79 Contracting States and the European Union acceded to it.⁷

8. The Convention is not equipment specific. It applies to any category of objects to which a Protocol relates. Accordingly, the Aircraft Protocol (2001) applies the Convention to airframes, aircraft engines and helicopters, the Luxembourg Rail Protocol (2007) applies the Convention to railway rolling stock and the Space Protocol (2012) applies the Convention to space assets. Under Article 49(1), the Convention enters into force in regard to a category of equipment once the relevant Protocol itself enters into force.

9. The Convention and the MAC Protocol need to be read together. However, to the extent of any inconsistency, Article 6(2) of the Convention provides that the Protocol prevails over the Convention. This rule is different to the usual practice in international treaties, under which protocols supplement conventions but only within the limits of the conventions themselves. Article 6(2) allows the protocols to control the Convention, in order to tailor the general rules in the Convention to the specific requirements of the industry covered by the relevant Protocol.

10. The Aircraft Protocol Official Commentary explains there are three advantages to the two-instrument approach:⁸

(i) It allows the Convention to provide a uniform set of rules that do not require equipment-specific considerations, instead of having a separate, stand-alone convention for each category of equipment. This avoids duplication and inconsistency between the non-equipment-specific provisions of one convention and those of another, and allows a uniform interpretation of such provisions, regardless of the type of equipment involved.

(ii) It avoids cluttering up the text of the Convention with detailed equipment-specific rules, and provides a convenient mechanism for modifying the Convention provisions by the Protocol to meet the particular needs of the industry sector involved.

(iii) It has enabled the different industry sectors to proceed at different speeds, thus allowing the Aircraft Protocol to be concluded without waiting for agreement on the protocols for railway rolling stock and space assets.

11. Article XXII(5) of the draft MAC Protocol provides that a State may not become party to the Protocol unless it is also a party to the Convention. The Convention contains, among others, core rules on the categories of international interests covered by it, the territorial sphere of application

⁶ Aircraft Protocol Official Commentary (4th edition 2019), Introduction, paragraph 2. While a general explanation of the operation of the Cape Town Convention is available also in the Official Commentaries for the Luxembourg Rail Protocol and the Space Protocol, this document relies primarily on the Aircraft Protocol Official Commentary, as it is the most recently updated of all three.

⁷ As at 19 June 2019. See <https://www.unidroit.org/status-2001capetown>.

⁸ Aircraft Protocol Official Commentary (4th edition 2019), paragraphs 2.14 - 2.16.

(based on the location of the debtor) the constitution of an international interest and its formal requirements, basic default remedies, the international registration system and priority rules that the MAC Protocol could not operate without. While there is nothing to preclude a State from becoming a party to the Convention without becoming a party to a Protocol⁹, the Convention only comes into force in relation to each category of object after ratification of/accession to the relevant Protocol.

B. Interaction with previous Protocols to the Cape Town Convention

12. Article II paragraph 4 of the draft MAC Protocol provides:

This Protocol does not apply to objects falling within the definition of "aircraft objects" under the Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment, "railway rolling stock" under the Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Railway Rolling Stock or "space assets" under the Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Space Assets.

13. The purpose behind this rule is to avoid the prospect of competing international interests in the same piece of equipment under different Protocols to the Cape Town Convention. Competing international registrations under different Protocols would be problematic, because it would require a party to search all international registries to assure themselves that a registration in the MAC registry would have priority. It could also mean that different insolvency alternatives could apply to the same object, depending on the declarations made by Contracting States in relation to each Protocol. Article II(4) was proposed by the Study Group at its third session, and approved by the Committee of Governmental Experts.¹⁰

14. The use of the Harmonized Commodity Description and Coding System (HS) to define the scope of the draft MAC Protocol ensures in most circumstances that overlap between the MAC Protocol and the existing three protocols will not occur. The HS lists aircraft and spacecraft under Chapter 88 and railway rolling stock under Chapter 86. The draft MAC Protocol does not list any 6 digit HS codes under these chapters. However, overlap could still occur where MAC equipment covered by an HS code listed in the draft MAC Protocol Annexes is subsequently attached to equipment which meets the definition of "railway rolling stock" under the Luxembourg Protocol.¹¹

15. While the likelihood of objects under the previous Protocols also falling within the scope of the MAC Protocol remains low, retaining Article II(4) appears prudent, as it provides additional security to stakeholders to the previous Protocols that their interests will not be affected by the MAC Protocol.

16. Article II(4) of the draft MAC Protocol is modelled on Article II(3) of the Space Protocol, which disapplies the Space Protocol to equipment falling under the definition of "aircraft objects" under the Aircraft Protocol.

⁹ Aircraft Protocol Official Commentary (4th edition 2019), paragraph 2.16.

¹⁰ This is a newly drafted article based on the decision at the third Study Group meeting to completely carve out the scopes of the previous Protocols from the scope of the MAC Protocol, for the sake of clarity and legal certainty. In the fifth Study Group draft this provision was a standalone Article in Chapter V of the Protocol, however at the fourth Study Group meeting it was decided to move it to Article II.

¹¹ Article 29(7)(a) of the Convention could also potentially preserve an international interest in equipment under the MAC Protocol that becomes subsequently attached to railway rolling stock. Article 29(7)(a) provides that the Convention does not affect pre-existing rights in an item that is installed on an object. As MAC equipment would be considered an "item" rather than an "object" under the Luxembourg Rail Protocol, an international interest in MAC equipment might continue to exist by virtue of Article 29(7)(a). However, it appears prudent to retain Article II(4) of the draft MAC Protocol to provide certainty on this matter.

C. Declarations under the Cape Town Convention and MAC Protocol

17. Both the Cape Town Convention and the draft MAC Protocol allow Contracting States to make declarations in relation to certain articles.¹²

18. Article XXVIII of the draft MAC Protocol provides that declarations made under the Convention “shall be deemed to have also been made under this Protocol, unless stated otherwise.” This is based on identical provisions in Article XXXI of the Aircraft Protocol and Article XXIX of the Luxembourg Rail Protocol.

19. The Aircraft Protocol Official Commentary explains that this article avoids the need for Contracting States to lodge fresh declarations under the Protocol in respect of matters covered by those already made under the Convention.¹³ As such, when a Cape Town Convention Contracting State ratifies the MAC Protocol and makes no mention of its declarations under the Convention, it is accepted that its existing declarations shall be deemed to apply also to the MAC Protocol. On this basis, Contracting States that want to modify their existing declarations under the Cape Town Convention in relation to the MAC Protocol would need to expressly do so in their instrument of ratification/accession.

20. In most circumstances, it is anticipated that Contracting States would want their existing declarations made under the Cape Town Convention to apply to the MAC Protocol. However, in some instances Contracting States have made Aircraft Protocol specific declarations under the Cape Town Convention, which may need to be revisited in relation to the MAC Protocol.¹⁴

¹² Article 56(1) of the Convention provides that “No reservations may be made to this Convention but declarations authorised by Articles 39, 40, 50, 52, 53, 54, 55, 57, 58 and 60 may be made in accordance with these provisions.” Article 52(2) of the Convention requires Contracting States to make a mandatory declaration in order for the Depositary to accept the instrument of ratification/accession. Article XXIX(1) of the draft MAC Protocol provides that “No reservations may be made to this Protocol but declarations authorised by Articles II, VII, XXV, XXVII and XXX may be made in accordance with these provisions.”

¹³ Aircraft Protocol Official Commentary (4th edition 2019), paragraph 2.339.

¹⁴ For example, of the 36 Contracting States that have made a declaration under Article 40 of the Convention (allowing for certain domestic non-consensual rights and interests to be registrable), 11 States have made declarations only in relation to aircraft-related non-consensual interests.

PART 2 - ISSUES RELATED TO SCOPE

D. Use of the Harmonized System

21. At the outset of the MAC Protocol project, some concerns were raised regarding the scope of the draft MAC Protocol.¹⁵ Specifically, the concern most often raised was that the scope of a draft MAC Protocol covering all mining, agricultural and construction equipment was simply too broad and uncertain. It was also queried whether it was possible to limit the scope of a draft MAC Protocol to certain types of mining, agricultural and construction equipment which were inherently mobile and high-value. After considering a variety of different approaches to limiting the scope of the draft MAC Protocol, one mechanism was identified that could be used to ensure its scope would be clear and appropriate.

22. The draft MAC Protocol uses the Harmonized Commodity Description and Coding System (HS) to identify the types of mining, agricultural and construction (MAC) equipment to be covered by its scope. The HS is a global nomenclature system developed by the World Customs Organisation (WCO) to achieve uniform classification of commodities and merchandise in international trade. Countries also use it to monitor controlled goods, calculate and collect duties and indirect taxes and compile trade and transport statistics. The HS is applied globally and covers 98% of all international trade. The WCO was consulted throughout the development of the MAC Protocol. WCO experts participated in the Study Group and provided input during the Committee of Governmental Experts process and in preparation for the Diplomatic Conference.

23. Article II paragraph 1 provides that the Convention shall apply in relation to MAC equipment as provided by the terms of the Protocol and its Annexes, irrespective of any intended or actual use of the equipment.¹⁶ Accordingly, the relationship between the MAC Protocol and the HS is established by Articles I, II, newly proposed Article XXXIV and the Annexes.

24. Article I paragraph 2 (a)(b) and (k) provide that "agriculture equipment"¹⁷, "construction equipment" and "mining equipment" are objects that fall under a Harmonized System code listed in the relevant draft MAC Protocol Annex. HS codes for mining equipment are listed in Annex 1, agricultural equipment in Annex 2 and construction equipment in Annex 3. The use of the HS to define the scope of the draft MAC Protocol ensures that the treaty will apply to predominantly high value equipment used primarily in the mining, agricultural and construction industries.

25. Article I paragraph 2 (g) defines the "Harmonized System" as the "Harmonized Commodity Description and Coding System governed by the International Convention on the Harmonized Commodity Description and Coding System". The intention of this definition is to clarify that, in using HS codes to define the scope of the treaty, the MAC Protocol incorporates the entirety of the HS, including the list of codes and headings themselves, as well as the General Interpretative Rules and

¹⁵ See [UNIDROIT 2006 – C.D. \(85\) 19](#), page 10; [UNIDROIT 2009 – C.D. \(88\) 17](#), paragraphs 143 – 147; [UNIDROIT 2010 – C.D. \(89\) 17](#); paragraphs 33 – 37; [UNIDROIT 2011 – C.D. \(90\) 18](#), paragraphs 68 – 70; [UNIDROIT 2012 – C.D. \(91\) 15](#), paragraphs 46 – 47; [UNIDROIT 2013 – C.D. \(92\) 17](#), paragraphs 44 – 48; [UNIDROIT 2014 – C.D. \(93\) 14](#), paragraphs 34 – 38.

¹⁶ The "irrespective of any intended or actual use" rule is explained in the section on multiple purpose equipment (Part 1F) of this document.

¹⁷ The Study Group decided and the Committee of Governmental Experts affirmed that the definition of 'agriculture' for the draft Protocol should be consistent with the Food and Agriculture Organization of the United Nations (FAO) definition, which includes forestry and fisheries (to the extent that fisheries covers aquaculture equipment). However, no HS codes covering aquaculture equipment have been proposed for inclusion in the draft MAC Protocol annexes.

the Section and Chapter Notes. The definition also links the MAC Protocol with the HS currently in force at any given time rather than the HS in force at the time of adoption of the MAC Protocol.¹⁸

26. For further information on the HS, please see the following:
- (a) Appendix I of this document provides a summary of the operation, organisation and structure of the HS.
 - (b) UNIDROIT 2019 – DCME-MAC – Doc. 6 provides a code-by-code analysis of the 42 HS codes listed in the draft MAC Protocol Annexes. It also provides an explanation of the procedure undertaken to select these codes, as well as a summary of the 2018 process under which States proposed new HS codes for inclusion in the Annexes.
 - (c) Part 6X of this document provides an explanation of the proposed amendment mechanism for the MAC Protocol, which takes into account revisions to the HS.

E. Use of Article 51(1) CTC Criteria – high value, mobile, uniquely identifiable

27. Article 51(1) of the Cape Town Convention establishes the process for extending the application of the Convention through the creation of additional Protocols:

The Depositary may create working groups, in co-operation with such relevant non-governmental organisations as the Depositary considers appropriate, to assess the feasibility of extending the application of this Convention, through one or more Protocols, to objects of any category of high-value mobile equipment, other than a category referred to in Article 2(3), each member of which is uniquely identifiable, and associated rights relating to such objects.

28. Article 51(1) sets out three elements that a category of equipment must demonstrate to be considered capable of being the subject of a future Protocol: (i) high-value, (ii) mobile and (iii) uniquely identifiable. In doing so, Article 51 naturally limits the scope of the Convention by ensuring it is not of general application.

29. As discussed in Part 2D of this Legal Analysis, the primary mechanism for limiting the scope of the draft MAC Protocol is the HS, through the selection of 6-digit HS codes which cover predominantly high-value, mobile and uniquely identifiable equipment. During CGE1, the Committee decided to add an explicit reference to Article 51(1) criteria to paragraph 2 of the Preamble. The Committee also added paragraph 4 to the Preamble, which references the integral role played by the HS in determining the scope of the Protocol in its application to MAC equipment.

High Value criterion

30. In the previous protocols, a description of the category of asset (airframe, aircraft engine, helicopter, railway rolling stock, or space asset) was sufficient for defining the applicability of the protocol, on the presupposition that these categories of assets inherently met the Article 51 criteria. This is not the case for MAC equipment, especially in relation to the high-value criterion. A small lawn mower could be viewed as MAC equipment, but is clearly outside the ambit of high value, commercial equipment for which the Cape Town Convention is designed to facilitate access to financing. As such, the MAC Protocol needed to devise a new approach to delineating its scope in relation to MAC equipment that diverged from the description-based scope mechanisms in the prior protocols.

¹⁸ For further information on how the HS codes listed in the MAC Protocol annexes are to be adjusted to reflect revisions to the HS, see Part 6X of this Legal Analysis.

31. At the first meeting of the Study Group it was discussed whether a minimum unit value threshold could be set in the preliminary draft MAC Protocol. There were significant concerns regarding this approach. Primarily, it would have been a departure from the previous Protocols where no such mechanism exists, despite the possibility of low value equipment satisfying the descriptive definition of “railway rolling stock” under the Luxembourg Rail Protocol. Secondly, setting such a minimum value threshold would exclude the application of the Protocol to much of the used equipment that is acquired and owned by businesses in developing economies. Thirdly, it could lead to unanticipated and undesirable market distortions, such as manufacturers and other sellers increasing the price of certain types of MAC equipment to meet the minimum unit value sales price and as such enjoy the benefits of the Protocol. Fourthly, fluctuations in currency exchange would further complicate the application of a minimum unit value threshold. Finally, “high value” is a somewhat relative concept: a \$30,000¹⁹ used tractor might not be considered to be high value equipment in developed economies, but would be considered to be high value in many developing countries.

32. Instead, the high value criterion is reflected in the selection of HS codes for inclusion in the draft MAC Protocol Annexes. This policy approach was adopted by the Study Group and approved by the Committee of Governmental Experts.²⁰ As discussed in UNIDROIT 2019 – DCME-MAC – Doc. 6, one of the five criteria considered in assessing whether an HS code is appropriate for inclusion in the draft MAC Protocol Annexes is whether it covers equipment that is predominantly high value. There is no formal threshold for what constitutes “high value” equipment. Proposed codes have been assessed on a case-by-case basis. Generally, an HS code covering MAC equipment that is separately financed or leased for commercial use will cover equipment that is sufficiently high value for inclusion in the Annexes. Individual unit prices for new equipment covered by the HS codes currently listed in the draft MAC Protocol Annexes range from \$10,000 - \$7,000,000. This range of individual unit prices within an HS code is important in determining whether it covers *predominantly high value equipment*. For example, where an HS code mainly covers MAC equipment with individual unit prices of between \$30,000 – \$200,000 but in some cases also covers MAC equipment worth \$10,000 or less, the code should not be excluded from the Annexes as it still covers predominantly high value equipment.

33. Limited types of low value MAC equipment may fall under HS codes listed in the MAC Protocol Annexes that cover mainly high value MAC equipment. However, the possibility of limited types of lower value equipment being covered should not strictly prevent the listing of an HS code. The possibility of financing low value equipment already exists in the Luxembourg Rail Protocol. The Luxembourg Rail Protocol allows for the registration of international interests in any individually serialised railway rolling stock that satisfies the definition in Article I(e). While the vast majority of railway rolling stock objects that meet this definition will be larger and high value, the definition also covers older and smaller railway rolling stock objects, regardless of their value.

Mobility criterion

34. As consistent with the existing protocols to the Cape Town Convention, the draft MAC Protocol does not contain a specific definition of “mobility”, and the HS would instead be used to limit the application of the Protocol to high value mobile equipment. This policy approach was adopted by the Study Group and approved by the Committee of Governmental Experts.²¹

35. Actual international mobility in terms of operation of equipment is not a vital element of the Cape Town Convention system. The majority of international interests registered under the

¹⁹ All dollar figures (\$) referred to in this document are references to United States Dollars (USD).

²⁰ CGE1 Report, paragraph 27, available <https://www.unidroit.org/english/documents/2017/study72k/cqe01/s-72k-cqe01-report-e.pdf>.

²¹ CGE1 Report, paragraph 27, available <https://www.unidroit.org/english/documents/2017/study72k/cqe01/s-72k-cqe01-report-e.pdf>.

International Registry for the Aircraft Protocol cover aircraft objects that actually service domestic rather than international routes. As such, it is clear that demonstrated routine international mobility for equipment is not required for a protocol to the Cape Town Convention to be successful. It should further be noted that the issue of defining “mobility” also arose during the negotiation of the Luxembourg Rail Protocol and that a specific definition could not be identified.

36. In a general sense, the MAC equipment within the scope of the Protocol is internationally mobile to the extent that a significant volume of it moves across borders in international trade. The draft MAC Protocol Annexes list 42 HS codes, which account for \$101,324,614,543 (over \$100 billion) worth of annual global trade in MAC equipment.²²

Unique identifiability criterion

37. Article XVII of the draft MAC Protocol provides that a description of equipment that contains its manufacturer’s serial number and such additional information as required to ensure uniqueness is necessary and sufficient to identify the object for registration purposes. This approach was agreed to at the second session of the Committee of Governmental Experts on the basis of recommendations made by the intersessional working group on registration criteria.²³ Use of the manufacturer’s serial number and supplementary information satisfies the Article 51(1) unique identifiability criterion. Further analysis on the draft MAC Protocol’s registry rules is available in part 5P.

F. Separate listing of Mining, Agricultural and Construction Equipment

38. The draft MAC Protocol covers mining, agricultural and construction equipment in the same instrument for several reasons. Primarily, including equipment from all three sectors in one instrument maximises the economic impact of the Protocol and ensure that it has global appeal. There are synergies between the three sectors in that the same type of equipment is commonly used across two or all three of the sectors. Further, having all three sectors covered by one instrument means that one registry will be created for the registration of international interests in equipment used in all three sectors, allowing for shared costs which would be lower than the costs associated with operating three separate registries.

39. While the MAC Protocol does apply to interests in equipment designed for use in all three sectors, the draft instrument does allow for Contracting States to limit its application to only one or two of the different sectors. As explained in Part 2D, “agricultural equipment”, “construction equipment” and “mining equipment” are defined as objects that fall under a Harmonized System code listed in the relevant draft MAC Protocol Annex. HS codes for mining equipment are listed in Annex 1, agricultural equipment in Annex 2 and construction equipment in Annex 3. Under Article II(3) of the draft Protocol, Contracting States are permitted to make a declaration applying the Protocol to the equipment comprised in one or two of the Annexes. For example, a Contracting State could make a declaration under Article II(3) applying the Protocol only to mining equipment listed in Annex 1 and construction equipment listed in Annex 3, but not agricultural equipment listed in Annex 2.

40. While Contracting States are given the choice of limiting the application of the Protocol to only one or two of the three sectors, the Protocol must still be applied to all equipment covered by the HS codes listed in the relevant Annexes. Accordingly, a Contracting State cannot choose to apply the Protocol only to select HS codes within an Annex. This principle is made clear by the wording of

²² Comtrade database, as maintained by the United Nations Statistics Division, 2017 export data (2017 data is the most up-to-date dataset available that is largely complete). Accessed 28 May 2019.

²³ UNIDROIT 2017 – Study 72K - CGE2 - Report, paragraphs 135 – 136, available <https://www.unidroit.org/english/documents/2017/study72k/cqe02/s-72k-cqe02-report-e.pdf>.

Article II(3), which states that a Contracting State may limit the application of the Protocol to the “entirety” of the equipment comprised in one or two of the Annexes. Article XXVII(5)(b) further clarifies that declarations made in relation to immovable property or insolvency (Articles VII and X) must apply to all equipment covered by the Protocol. As such, a Contracting State cannot apply different insolvency remedies to different Annexes.

41. Of the 42 HS codes currently listed in the draft MAC Protocol Annexes, 24 are listed in two or three Annexes because the equipment they cover are used in two or all three of the MAC sectors. Where a Contracting State makes a declaration limiting the application of the Protocol to the equipment covered in only one Annex, any equipment covered by an HS code listed in that Annex will be within the scope of the Protocol in that Contracting State, regardless of its intended or actual use.²⁴ This provision was included in the draft Protocol at CGE2 to achieve the policy goal of ensuring that the actual or intended use of MAC equipment would not affect the ability of a party to create an international interest in MAC equipment or affect an existing international interest in that equipment.²⁵ For example, a Contracting State could make a declaration applying the Protocol only to Annex 1 (mining equipment), but not Annexes 2 or 3. HS code 843061 (covering tamping or compacting machinery) is listed in both Annexes 1 and 3. Because the Contracting State has applied the Protocol to Annex 1 and HS code 843061 is listed in Annex 1, the equipment covered by that HS code will be within the scope of the Protocol in the Contracting State, regardless of how it is used. This means that equipment under HS code 843061 used in construction would still fall within the scope of the Protocol, even though the Contracting State had not specifically applied the MAC Protocol to construction equipment under Annex 3.

G. Exclusion of general use equipment

42. The MAC Protocol will apply only to equipment designed for use in the mining, agriculture or construction sectors. The HS codes listed in the Annexes were included on the basis that they cover equipment predominantly used in the mining, agriculture or construction sectors. HS codes covering equipment commonly used outside the MAC sectors must be excluded from the Annexes. As such, the selection of the HS codes for inclusion in the draft MAC Protocol Annexes is the primary filter to ensure that general or multiple purpose equipment is not included within the scope of the instrument.

43. It is important that the draft MAC Protocol Annexes only list HS codes covering equipment used predominantly in the MAC sectors because once an HS code is listed, all equipment within that HS code is within the scope of the MAC Protocol. As discussed in Part 2F above, Article II(1) provides that the Convention shall apply to MAC equipment covered by the HS codes listed in the Annexes “irrespective of any intended or actual use of the equipment”. The purpose of this rule is to ensure certainty and predictability in the application of the Protocol. Without this rule, there could be a risk that a party may challenge the validity of an international interest by asserting that the equipment is being used in another sector.

44. Through a combination of these two principles of (i) only listing HS codes in the Annexes that cover equipment predominantly used in the MAC sectors and (ii) covering all equipment within a listed HS code, regardless of intended or actual use, the draft MAC Protocol seeks to strike a balance between ensuring its scope is limited to MAC equipment while also providing clarity and certainty in its application. Further information on how the draft MAC Protocol treats components, parts and accessions is available in Part 3J of this document.

²⁴ Article II(1) of the draft MAC Protocol provides that “the Convention shall apply in relation to mining equipment, agricultural equipment and construction equipment as provided by the terms of this Protocol and Annexes 1, 2 and 3 irrespective of any intended or actual use of the equipment”.

²⁵ UNIDROIT 2017 – Study 72K - CGE2 - Report, paragraphs 61 – 68, available <https://www.unidroit.org/english/documents/2017/study72k/cqe02/s-72k-cqe02-report-e.pdf>.

H. Treatment of inventory

45. The draft MAC Protocol contains a special set of rules (Article XII) that allows Contracting States to decide whether to preserve their existing national inventory financing regimes or to apply the MAC Protocol to inventory financing. While the policy rationale underpinning these rules was initially agreed to at CGE2, possible deficiencies with the current Article XII have been identified in the process leading to the Diplomatic Conference.

46. During CGE2, the MAC Working Group (MWG) proposed an additional article in relation to the MAC Protocol's application to MAC equipment held by a dealer as inventory.²⁶ During discussions, concerns also emerged regarding the position of buyers of equipment from dealers under the Protocol. These issues were referred to the Drafting Committee, which produced Article XII in response.

47. Article XII, as approved by the CGE, has two underlying policy rationales:

- (1) Contracting States should have a choice as to whether the MAC Protocol applies to inventory financing. Application of the MAC Protocol to inventory financing in States that have well developed inventory financing systems might cause undesirable disruption. However, in other States the application of the MAC Protocol to inventory financing might offer significant improvements over existing domestic laws. To address these two competing concerns, the MAC Protocol should permit Contracting States to opt-out of the MAC Protocol's application to inventory financing.
- (2) The MAC Protocol should consider addressing the rights of buyers and lessees of MAC Equipment from dealers. In the MAC sectors, it is common for end-users of equipment to purchase or lease equipment from a dealer. However, Article 29(3)(a) and (4)(a) provide that buyers, conditional buyers and lessees acquire an interest in MAC equipment *subject* to a registered international interest. In many States, this limitation of the buyer take-free rule would run contrary to domestic laws and reverse the reasonable commercial expectation that a purchaser of MAC equipment from a dealer would be receiving good title to that equipment. To address this concern, the MAC Protocol may need to ensure that qualifying buyers, conditional buyers or lessees of MAC equipment from a dealer take their interest free from a registered interest granted by the dealer under the conditions similarly imposed by domestic law.

48. Where a Contracting State has opted-out of the Protocol's application to inventory financing, the MWG has suggested that the opt-out of the application of the Protocol should be complete rather than partial (either the MAC Protocol or the existing domestic regime should regulate inventory financing, rather than having a hybrid system which allows partial application of the MAC Protocol remedies while retaining the existing domestic law priority rules). Maintaining two clear options (application of the MAC Protocol or the existing domestic regime to inventory financing) provides clarity for Contracting States and allows manufacturers, dealers, end-users and financiers to preserve their existing practices.

49. During discussions at the Cape Town Convention academic conference in September 2018,²⁷ several problematic elements in the wording of Article XII were identified. On close consultation with international experts, the Secretariat submits the following alternative drafting for Article XII for

²⁶ UNIDROIT 2017 – Study 72K – CGE2 – Report, paragraphs 175 – 198, available <https://www.unidroit.org/english/documents/2017/study72k/cge02/s-72k-cge02-report-e.pdf>. Examples of dealers holding MAC equipment as inventory could include manufacturer dealerships, retail distributors and rental companies.

²⁷ <https://www.unidroit.org/89-news-and-events/2481-7th-cape-town-convention-academic-project-held-in-oxford>.

discussion at the Diplomatic Conference, which is designed to better reflect the two policy positions described above.

Proposed new drafting in relation to the treatment of inventory

Article I(2)

(c) "dealer" means a person (including a manufacturer) that sells or leases equipment in the ordinary course of its business; (unchanged from the draft MAC Protocol)

(j) "inventory" means equipment held by a dealer for sale or lease in the ordinary course of its business; (unchanged from the draft MAC Protocol)

(k)bis "non-Convention law" means the law (other than the Convention and this Protocol) of the State in which inventory is situated at the time that a buyer, conditional buyer or lessee acquires its interest in or rights over the inventory.

Article XII

1. A buyer, conditional buyer or lessee of inventory from a dealer acquires its interest in it free from any registered interest as to which the dealer is the debtor if, under the non-Convention law, the buyer, conditional buyer or lessee would acquire its interest free of an interest equivalent to that registered interest and is effective against third parties.

2. Paragraphs 3 and 4 apply only where a Contracting State has made a declaration pursuant to Article XXVII(4).

3. An interest in inventory created or provided for by an agreement under which the dealer is the debtor is not an international interest if the inventory is situated in a Contracting State referred to in paragraph 2 at the time the interest is created or arises.

4. Article 29(3)(b) and (4)(b) of the Convention do not apply to a buyer, conditional buyer or lessee of inventory from a dealer if the inventory is situated in a Contracting State referred to in paragraph 2 at the time that a buyer, conditional buyer or lessee acquires its interest in or rights over the inventory.

Comments

50. The new definition "non-Convention law" is necessary to identify the relevant domestic secured transactions law, while excluding the Convention and Protocol and domestic laws implementing the Convention and Protocol. This new definition is proposed because a simple reference to "domestic law" in paragraph 1 might also capture domestic law consisting of or implementing the Cape Town Convention and Protocol, which would prevent the rule in paragraph 1 from functioning effectively.

51. The definition of "non-Convention law" uses the location of the inventory as the appropriate connecting factor. This is consistent with the proposed Article XII paragraph 3, which is explained in more detail below.

Paragraph 1

52. Paragraph 1 overrides Articles 29(3)(a) and (4)(a) by providing any protections that exist under domestic law for buyers, conditional buyers and lessees of inventory from dealers. Paragraph 1 would replace paragraphs 1 and 2 of the current Article XII because it refers compendiously to the rights of a "buyer, conditional buyer and lessee". The purpose of paragraph 1 is to take the standards of any existing take-free rules under domestic law that applies to a buyer, conditional buyer or lessee, and apply those standards to a buyer, conditional buyer or lessee who acquires equipment held as inventory from a dealer, in relation to a registered interest on the international registry. This approach effectively applies the take-free rule in the non-Convention law to the registered interest (as if the registered international interest was a registered interest in a domestic registry). This

approach is proposed for two reasons (as opposed to attempting to apply the domestic law take-free rule in its entirety):

- (i) The non-Convention law in many States may not provide for a domestic registry for interests of the type covered by the Convention (which would cast doubt over the way in which the take-free rule would operate).
- (ii) Applying all aspects of the non-Convention law's take-free rules might make it necessary to determine whether an agreement under the Convention had satisfied formality rules in relation to constitution of the interest that is to be subjected to the take-free rule, which would be complicated and undesirable.

53. The language "equivalent to that registered interest" clarifies that the buyer take-free standards adopted from the non-Convention law should be equivalent to the type of registered interest affected by the take-free rule. The concept of an "equivalent" interest is derived from Article 39(1)(a) of the Convention, which provides the right for Contracting States to make a declaration in relation to the protection of non-consensual interests which have priority over national law interests "equivalent" to that of a registered international interest. For example, a buyer acquiring equipment from a dealer that is holding the equipment as inventory under a security agreement should only be able to take-free from a registered international interest in the equipment under the circumstances in which the non-Convention law allows a buyer to take free from the chargee's interest. This is to accommodate the fact that the take-free standards applicable to chargees under the non-Convention law may differ from the take-free standards that apply as against the holders of other types of interests.

54. "Registered interest" is intended to apply to any registered interest as defined in the Convention, including registered non-consensual rights or interests under Article 40 and registered national interests under Article 50.

55. The test is limited to where the non-Convention law would allow the buyer to take-free from an interest that is "effective against third parties". This limitation is designed to prevent a buyer from utilising a potentially more lenient take-free rule under the non-Convention law that might allow a buyer to take free of an interest for which the holder had not taken appropriate steps to make its interest effective against third parties (such as registration on a domestic law registry, where this is contemplated by the non-Convention law). This requirement would not require the domestic law interest to be effective against all third parties under all circumstances.

56. It is important to emphasise that while this rule would apply mandatorily under the Convention, it would only apply to buyers, conditional buyers and lessees of equipment held as inventory from dealers. Parties acquiring equipment from someone other than a dealer, for example a farmer buying a harvester from another farmer, would acquire that interest subject to a registered international interest, consistent with Article 29(3)(a) of the Convention.

Illustrative situation A: A harvester, held in inventory by a dealer, is located in a Contracting State that has not opted-out of Article XII. The harvester is subject to a charge constituting an international interest registered in the international registry in favour of a bank that finances all of the dealer's inventory. A buyer purchases the harvester from the dealer, unaware of the existing international interest over the harvester.

Example A1: Under the non-Convention law in the harvester's location, a buyer from a dealer in the ordinary course of business can take-free of a charge granted by the dealer even if it has been registered in the domestic registry, as long as the buyer has no knowledge of that it would be violating the existing registered interest. Because the buyer in the example has no knowledge of the violation of the charge granted by the dealer, the buyer will acquire

its interest in the harvester free of the charge, even though it has been registered in the international registry. This would be the result whether or not the inventory is located in a Contracting State that has made an opt-out declaration for inventory financing, as Article XII(1) is currently drafted as a mandatory rule for all Contracting States.

Example A2: Under the non-Convention law in the harvester’s location, a buyer from a dealer in the ordinary course of business can take free of a charge if it has not been made effective against third parties through registration, even if the buyer is aware of the charge. However, it cannot take free of an existing charge if it has been made effective against third parties through registration. Under the non-Convention law, the buyer would not take free of an interest that is equivalent to the registered international interest (because the take-free rule under the non-Convention law only allows a buyer to take free of an unregistered charge, not a registered charge), so the buyer will acquire its interest in the harvester subject to the registered international interest, and not take free of it.

Example A3: Under the non-Convention law in the harvester’s location, a buyer from a dealer in the ordinary course of business can take free of a registered charge granted by the dealer, but cannot take free of the ownership interest of a lessor under a lease. As the bank’s international interest is a charge and not a lease, the equivalent interest under non-Convention law test is also a charge. The non-Convention law allows a buyer to take free of a registered charge, so the buyer will acquire its interest in the harvester free of the charge even though it has been registered in the international registry.

*Paragraph 2*²⁸

57. Paragraph 2 provides that a Contracting State can opt-out of the Protocol’s application to inventory financing (“inventory financing opt-out”) by declaring that it will apply paragraphs 3 and 4.

*Paragraph 3*²⁹

58. Paragraph 3 provides that an interest in inventory under which the dealer is the debtor is not an international interest. This rule, together with paragraph 4 which disapplies Article 29(3)(b) and 29(4)(b) of the Convention, are the core components of inventory financing opt-out. This is explored in further detail in the paragraph 4 analysis below.

59. Paragraph 3 additionally provides that the connecting factor in determining whether the inventory financing opt-out applies is the location of the inventory in the declaring State at the time the interest is created or arises. This is a proposed change to paragraphs 4 and 5 of the current Article XII, which provide that the connecting factor is the location of the debtor. The basis of this proposed change is that using the location of the inventory as the connecting factor better reflects the underlying policy for the inventory financing opt-out. The opt-out permits States whose laws adequately facilitate inventory financing to retain those laws rather than subject inventory financing to the Protocol’s asset-by-asset, object-specific registration requirements. The governing law in such situations is typically the law of the State in which the inventory collateral is located. It follows that a State that makes an opt-out declaration would most likely be seeking to maintain the currently applicable law for inventory situated in that State. Using the location of the debtor as the connecting factor can also create uncertainties.³⁰ Based on this reasoning, it is suggested that the more

²⁸ The proposed paragraph 2 is intended to replace paragraph 3 of the current Article XII in the draft MAC Protocol.

²⁹ The proposed paragraph 3 is intended to replace paragraphs 4 and 5 of the current Article XII in the draft MAC Protocol.

³⁰ Paragraph 5 of the current Article XII is intended to specify a single State whose opt-out declaration would control in the case of dealer. This follows the similar goal reflected by Article 60(2)(b) of the Convention.

appropriate connecting factor for the inventory financing opt-out is the location of the inventory rather than the location of the debtor.

*Paragraph 4*³¹

60. Article 29(3)(b) and (4)(b) of the Convention provide that a buyer, conditional buyer or lessee acquires an interest in equipment free from an unregistered interest even if it has actual knowledge of such an interest. The proposed new paragraph 4 of Article XII disappplies this rule in relation to buyers, conditional buyers or lessees of inventory from a dealer where the inventory is situated in a Contracting State that has exercised the inventory financing opt-out. In combination with paragraph 3, this has the effect that the declaring State's domestic law will continue to determine whether and in what circumstances a buyer, conditional buyer or lessee can take free from interests in equipment held in inventory to which the dealer is the debtor.³²

Interaction between Article XII of the Protocol and Articles 40 and 50 of the Convention

61. Articles 40 and 50 of the Convention allow Contracting States to make declarations allowing for the registration of "non-consensual rights and interests" and "national interests" in the international registry. While the nature of these two additional types of registrable interests differ, they are subject to the normal priority rule in Article 29(1) of the Convention, which provides that a registered interest has priority over any other interest subsequently registered or over an unregistered interest.

62. As explained above, where a Contracting States has exercised the inventory financing opt-out, interests in equipment held as inventory under which the dealer is the debtor are not international interests and cannot be registered in the international registry. As a result, where a Contracting State had additionally made declarations under Articles 40 and 50 of the Convention allowing for the registration of registrable non-consensual rights and interests and national interests in the international registry, a registrable non-consensual right or interest or a national interest in a dealer's inventory that is registered in the international registry will necessarily have priority over an interest in the equipment granted by the dealer (that would have been an international interest but for the opt-out), as the interest granted by the dealer would not be governed by the MAC Protocol.

63. This interaction between Article XII and Articles 40 and 50 might lead to unfairness, especially where a registrable non-consensual right or interest or national interest is registered in the international registry after the creation of the interest held by the inventory financier. Such circumstances are likely to be rare, given the relatively low number of Contracting States that have made relevant declarations under Articles 40 and 50.³³ On this basis, it might be sufficient not to directly address the issue in the Protocol, in order to avoid additional complexity.

Article 4 of the Convention provides four alternative connecting factors that are not necessarily mutually exclusive. Multiple dealer locations could harbour considerable uncertainty in this context. For example, a dealer's State of incorporation might make an opt-out declaration but the State of its principal place of business might not so declare.

³¹ The proposed paragraph 4 is intended to replace paragraphs 6 and 7 of the current Article XII in the draft MAC Protocol.

³² The phrase "even if it has actual knowledge," in Articles 29(3)(b) and (4)(b) of the Convention are not included in paragraph 4. It is understood that this reflects an intention to defer to the non-Convention law in determining whether knowledge has an effect on a buyer, conditional buyer or lessee's take free right of an unregistered interest.

³³ As of February 2019, 36 Contracting States have made a declaration under Article 40 allowing for certain domestic non-consensual rights and interests to be registrable, although 11 of these States have made declarations only in relation to aircraft-related non-consensual interests. Five countries have made a declaration under Article 50 providing for the registration of national interests in relation to internal transactions.

64. However, should negotiating States wish to adopt a rule in the Protocol to address this issue, one possible solution could be to provide that a declaration under Article 40 or 50 does not apply to non-consensual rights or interests or national interests that arise over equipment while it is held by a dealer as inventory (in Contracting States that have exercised the inventory financing opt-out). The following draft provisions are intended to achieve this outcome:

5. If a Contracting State has made a declaration under Article XXVII(4), any declaration that it makes under Article 40 of the Convention will be taken not to extend to non-consensual rights or interests that arise over equipment while it is inventory situated in that Contracting State.

6. If a Contracting State has made a declaration under Article XXVII(4), any declaration that it makes under Article 50 of the Convention will be taken not to extend to a national interest that is granted over equipment while it is inventory situated in that Contracting State.

Necessity of the mandatory application of the take-free protections for buyers, conditional buyers and lessees of inventory

65. The take-free rule for buyers and lessees of equipment from dealers established in proposed Article XII paragraph 1 is currently a mandatory provision that applies to all Contracting States, as agreed by negotiating States during CGE2. The drafting of paragraph 1 designed to achieve this policy outcome has been developed through lengthy consultations with international experts. However, it nonetheless creates a significant degree of complexity in the Protocol.

66. Paragraph 1 will have no practical operation in Contracting States that exercise the inventory financing opt-out in paragraph 2, as paragraph 2 deems interests in equipment held in inventory by a dealer not to be international interests. This leaves a conflict between such an interest and a buyer, conditional buyer or lessor to be resolved by the non-Convention law, rather than paragraph 1. Therefore, even if paragraph 1 were removed, Contracting States could still achieve the same protections for buyers, conditional buyers and lessees of inventory by making a declaration under paragraph 2 to apply paragraphs 3 and 4.

67. The rationale for both providing the mandatory take-free rule in paragraph 1 and allowing a Contracting State to exercise the opt-out in paragraph 2, is that States that choose not to exercise the inventory financing opt-out may nonetheless want to preserve that part of their domestic inventory finance regimes that is their buyer take-free rules. In simpler terms, the underlying policy rationale is based upon the assumption that States that want to reform their inventory financing regimes (under the Convention) nonetheless would want to preserve their buyer take-free rules.

68. Negotiating States may wish to reaffirm that the mandatory application of the take-free protections for buyers, conditional buyers and lessees of inventory in paragraph 1 is desirable, taking into account (i) that the same substantive effect can be achieved by Contracting States making the inventory financing opt-out, and (ii) the additional complexity created by paragraph 1.

PART 3 - ISSUES RELATED TO ASSOCIATION WITH OTHER ASSETS

I. Association with immovable property³⁴

69. Issues may arise where MAC equipment becomes so associated with immovable property that domestic law interests in the immovable property extend to the MAC equipment. There are sensitivities in relation to immovable-associated equipment, as States often regard the treatment of their territory as an issue of sovereignty, making it particularly difficult to harmonise immovable-related interests at an international level. Despite these sensitivities, this issue should be directly addressed in the draft MAC Protocol. No guidance can be drawn from the three previous protocols to the Cape Town Convention, as aircraft, railway rolling stock and space objects are not affixable to immovable property.

70. Initially, association with immovable property appeared to be a matter of limited significance, as it was originally understood that it would only be relevant for types of MAC equipment that were physically connected to immovable property (for example, certain types of cranes and drills). However, following a comparative law analysis conducted by the Secretariat, it became apparent that certain jurisdictions permitted interests in immovable property to extend to mobile equipment that was utilised for the economic exploitation of the immovable property, even where there was no physical connection between the equipment and the immovable property.

71. The following principles underpin the draft MAC Protocol's approach to association with immovable property (as adopted by the Study Group and approved by the Committee of Governmental Experts):

- (a) Association with immovable property should be directly addressed by a standalone article in the draft MAC Protocol.
- (b) The article governing association with immovable property should be the object of a mandatory declaration, giving Contracting States flexibility in their approach to the issue, but also requiring States to make an active selection of the alternative they favour.
- (c) Due to the complex and sensitive nature of the issue, the draft MAC Protocol should provide several alternative options for Contracting States regarding the relationship between international interests in MAC equipment and domestic interests arising out of immovable property law.
- (d) The article and various options need to take into account all potential interests arising out of association with immovable property (i.e. interests arising out of physical connection between the equipment and the immovable property, referred to as "fixtures" in some jurisdictions and interests arising out of the utilisation of mobile equipment for the economic exploitation of the immovable property, referred to as "accessories" in some jurisdictions).
- (e) If possible, the article should avoid substantively defining the words "fixture" and "accessory".
- (f) The article should apply the declaration made by the Contracting State in which the immovable property is located, as opposed to the declaration of the Contracting State where the debtor is situated (the application of the Cape Town Convention itself is based on the debtor being situated in a Contracting State).

72. Article VII of the draft MAC Protocol addresses the issue of association with immovable property. Article VII provides that a Contracting State must apply one of three alternative approaches in resolving the potential conflict between international interests in MAC equipment and domestic interests in the immovable property that the MAC equipment has become associated with:

³⁴ In early Study Group papers, this issue was considered under the heading of 'fixtures'.

Alternative A: An international interest in MAC equipment retains its priority as against any domestic interests in the immovable-associated equipment that exist as a result of the equipment's association with immovable property, to the extent that the MAC equipment is "removable".

Alternative B: A distinction is made between MAC equipment that becomes so associated with immovable property that it loses its individual legal identity (under the domestic law of the country in which the equipment is located) and MAC equipment that retains its legal identity. International interests in MAC equipment that loses its individual legal identity are subordinated to domestic interests (where the domestic law provides for such a subordination), whereas international interests in MAC equipment that retains its individual legal identity lose their priority only where (i) the interest in the immovable property is registered under domestic law prior to the registration of the international interest and (ii) the equipment has become associated with the immovable property prior to the registration of the international interest in the equipment.

Alternative C: The domestic law of the Contracting State in which the equipment is located determines whether the international interest is subordinated to domestic interests that exist as a result of the equipment's association with immovable property.

73. Paragraph 1 of Article VII also provides that the domestic law determines whether the international interest is subordinated to domestic immovable property interests where the equipment is located in a non-Contracting State.

74. The Study Group and Committee of Governmental Experts considered that the policy and legal approaches of the three alternatives give Contracting States sufficient flexibility in balancing the primacy of the international interests over domestic interests and the protection of immovable property interests.

Reformulation of Alternative A

75. Alternative A provides the strongest protection for the holder of an international interest in MAC equipment as against any domestic law interests arising out of its association with immovable property. At CGE2, the Committee decided that the priority of the international interest under Alternative A should be limited where the physical removal of the equipment would cause significant physical damage. The Committee requested the Secretariat to further consider exactly how the qualifier limiting the application of Alternative A should be formulated.³⁵

76. On close consultation with international experts, the Secretariat proposes the following redrafting of Alternative A for the consideration of the Diplomatic Conference:

Article VII Alternative A

3. Subject to paragraph 4, the association of immovable-associated equipment with immovable property does not affect its status as equipment under this Protocol.

4. Paragraph 3 does not apply to equipment which becomes so physically connected to immovable property that the disconnection of the equipment from the immovable property would result in significant damage to the immovable property and equipment. Whether the physical disconnection of the equipment from the immovable would result in significant

³⁵ UNIDROIT 2017 – Study 72K - CGE2 - Report, paras 76 – 87, available <https://www.unidroit.org/english/documents/2017/study72k/cqe02/s-72k-cqe02-report-e.pdf>.

damage shall take into account the anticipated value of the equipment following its disconnection and the cost of repairs to the equipment and immovable property.

77. The proposed text of paragraph 3 establishes the principle underpinning Alternative A: that international interests in MAC equipment are unaffected by that equipment becoming associated with immovable property. The proposed text of paragraph 4 provides a limitation on the underlying principle in paragraph 3. Paragraph 4 establishes a factual test to determine whether the physical disconnection of the equipment from the immovable property would cause such “significant damage” that it would be unreasonable to remove the equipment.

78. The goal of the significant damage test is to ascertain whether the equipment would have a net positive value, after taking into account the damage to both the immovable and the equipment caused by the disconnection, which should be made available to the creditor. As such, the significant damage test requires the balancing of the anticipated residual value of the equipment post removal against the cost of repair of both the equipment and the immovable property. Where the cost of the repairs to both the equipment and the immovable are greater than the residual value of the equipment post removal, the removal of the equipment would cause “significant damage”.

79. If the equipment fails the significant damage test, paragraph 3 no longer applies and the domestic law will determine the relationship between an international interest in the immovable-associated equipment and a domestic interest arising out of the equipment’s association with the immovable (the rule established in Alternative C). As such, the holder of an international interest in equipment that fails the significant damage test would have whatever rights are granted under domestic law.

80. There is no underlying presumption under Alternative A that equipment needs to retain its legal identity as equipment under the applicable law. The only relevant consideration in determining whether equipment has retained its status as equipment under Alternative A is the significant damage test. Whether the equipment would cease to be treated as a separate asset under the *lex situs* is irrelevant.

81. The significant damage test should be applied without regard to whether the debtor or the creditor is responsible for any related repairs or would suffer the loss with respect to such damage, such matters being left to the applicable law other than the Convention and the Protocol and, subject to the applicable law, the agreement of the parties.

82. The proposed redrafting of Alternative A does not need to provide a time of determination in applying the paragraph 4 significant damage test. The relevant time for applying the paragraph 4 test would be a future time, which would necessarily be indeterminate at the outset of a transaction. If there were a dispute as to whether removal of the equipment would fail the significant damage test, the court would consider the equipment’s situation at the time of the dispute. If the equipment was already physically connected to the immovable property to the extent that its removal would fail the significant damage test at the time of the transaction, the equipment would not obtain its status of “equipment” under the Protocol and the international interest would never be created.

83. In consultations with international experts, a suggestion was made that Article VII Alternative A contain a provision to the effect that, if an international interest is created in equipment at the inception of a transaction, a person challenging the status of the equipment at a later time would have the burden of proof as to any change in status. However, the prevailing view was that the same result would exist under usual evidentiary rules and that no such specific provision is necessary.

Definition of "immovable-associated equipment"

84. As discussed at length in Appendix II of the Legal Analysis, there is no universally accepted definition of "fixture" and "accession". These terms have very different meanings in jurisdictions across the world. Further, the elements considered in different jurisdictions to determine whether an object has become associated with immovable property to the extent that an interest under the domestic law extends to the object also vary greatly.

85. In view of these complexities, the draft MAC Protocol attempts to provide a basic definition of only the term "immovable-associated equipment".

86. Article I(2)(h) of the draft MAC Protocol provides that "immovable-associated equipment" means equipment that is so associated with immovable property that an interest in the immovable property extends to the equipment under the law of the state in which the immovable property is situated. The article does not provide any substantive legal definition of "immovable-associated equipment", it simply refers to domestic law of the country in which the equipment is located to determine whether an interest under immovable property law extends to the equipment. The term "associated" is used because other similar terms such as "connected", "attached" and "affixed" all imply a degree of constant physical connection between the equipment and the immovable property, which may not be necessary in some jurisdictions for an interest in the immovable to extend to the equipment (as noted above). Article I(2)(h) also does not distinguish between different types of immovable property-related interests under the domestic law (i.e. it does not distinguish between fixtures and accessories).

87. However, Alternative B still makes a distinction between different types of immovable-associated equipment. Alternative B is based upon a proposal from the German Ministry of Justice.³⁶ The benefit of Alternative B is that it distinguishes between different types of immovable-associated equipment without actually using the terms "fixtures" and "accessories", and in doing so it restricts the circumstances under which an international interest in immovable-associated equipment will lose its priority as against an interest arising from its association with immovable property. This Alternative is dependent upon the use of the criterion of the complete loss of individual legal identity, even though it does revert to the national law of the location of the immovable to determine the circumstances under which the loss of individual legal identity occurs.

Application of Article VII to non-Contracting States

88. Article VII(1) provides:

Where immovable-associated equipment is situated in a non-Contracting State, this Protocol does not affect the application of any law of that State that determines whether an international interest in the immovable-associated equipment ceases to exist, is subordinated to any other rights or interests in the immovable-associated equipment, or is otherwise affected by the association of the equipment with immovable property.

89. The Study Group discussed what would occur in relation to international interests in MAC equipment that became associated with immovable property in non-Contracting States. The prevailing view was that in the absence of an express provision stating otherwise, Article 29 of the Cape Town Convention would apply, and the international interest would take priority over any domestic interest arising out of the equipment's association with immovable property. This outcome would be broadly consistent with the prior Protocols to the Cape Town Convention in terms of maintaining the priority of the international interest over domestic interests.

³⁶ For further information see Appendix II.

90. However, as Article 29 was not drafted to contemplate an international interest conflicting with an interest arising out of association with immovable property, the Study Group concluded that it would be prudent to include a provision providing that international interests in MAC equipment did not interfere with immovable property-related interests in non-Contracting States. The drafting of the provision in the fifth Study Group draft was based on Article 29(7), but that approach has been changed in the current draft MAC Protocol.

91. The Study Group also discussed an approach based on applying the priority rules of the Contracting State in which the debtor was located to non-Contracting States, in circumstances where the equipment has moved to the non-Contracting State and there is a conflict between immovable property-related interests and international interests under the draft MAC Protocol. However, this approach was not favoured as there is no real substantive policy rationale as to why the State where the debtor is situated should have the power to determine whether the non-Contracting State's immovable property law or the rules of the draft MAC Protocol should prevail.

92. Substantive legal background regarding association with immovable property and a jurisdictional analysis on the operation on fixtures and accessories under domestic legal regimes is available in Appendix II of this Legal Analysis.

J. Accessions/Parts

Treatment of accessions under the Cape Town Convention and existing Protocols

93. Under Cape Town Convention terminology, "accessions" are items of equipment that are not capable of being subject to an international interest (*i.e.* are not "objects") but may be installed/connected/affixed to an object subject to an international interest.

94. Article I(2)(e) of the Luxembourg Rail Protocol provides: "railway rolling stock" means vehicles movable on a fixed railway track or directly on, above or below a guideway, together with traction systems, engines, brakes, axles, bogies, pantographs, accessories and other components, equipment and parts, in each case installed on or incorporated in the vehicles, and together with all data, manuals and records relating thereto.

95. Article I(2)(k) of the Space Protocol provides: "space asset" means ... together with all installed, incorporated or attached accessories, parts and equipment and all data, manuals and records relating thereto.

96. The Aircraft Protocol includes three separate definitions of aircraft engines, airframes, and helicopters, which can all constitute separate objects under the Protocol. Unlike the other Protocols, it treats engines as separate objects. Aircraft Protocol Article I(2) provides: (b) "aircraft engines" means ... together with all modules and other installed, incorporated or attached accessories, parts and equipment and all data, manuals and records relating thereto; (e) "airframes" means ... together with all installed, incorporated or attached accessories, parts and equipment (other than aircraft engines), and all data, manuals and records relating thereto; (l) "helicopter" means ... together with all installed, incorporated or attached accessories, parts and equipment (including rotors), and all data, manuals and records relating thereto.

97. In negotiating the Luxembourg Rail Protocol, a decision was made not to recognise railway engines (as opposed to railway rolling stock) as distinct objects. This is because railway engines are generally not subject to separate asset-based financing. While there are circumstances where railway engines are removed and installed in other trains, this practice was not widespread enough to warrant including them as separate objects under the Protocol. The situation can be distinguished from the longstanding practice in the aviation industry of separate financing for aircraft engines.

Treatment of accessions and parts in the draft MAC Protocol

98. In developing the draft MAC Protocol, the MAC Working Group advised that in general, accessions/parts for equipment in the MAC sectors are not subject to separate asset-based financing. There are of course exceptions to this general rule, replacement tires for high value earth moving machinery can cost in excess of \$50,000 each and might be individually financed under certain circumstances. However, the situation for the financing of accessions/parts in the MAC sectors is generally analogous to the situation in the rail sector, rather than in relation to financing engines in the aviation sector.

99. As such, the treatment of accessions in defining MAC equipment under the draft MAC Protocol attempts to approximate the treatment of accessions in defining railway rolling stock under the Luxembourg Rail Protocol. The Committee of Governmental Experts decided to amend the definitions of mining, agricultural and construction equipment in Article I(2)(a), (b) and (k) to cover "*all installed, incorporated or attached accessories, components and parts which do not fall within a separate HS code listed in that Annex, and all data, manuals and records relating thereto*". This language generally reflects the language of the Luxembourg Rail Protocol in defining accessories ("*all installed, incorporated or attached accessories, components and parts... and all data, manuals and records relating thereto*"), although the Luxembourg Rail Protocol also lists additional types of parts specific to railway rolling stock ("*engines, brakes, axles, bogies, pantographs*").

100. However, the additional aspect of the definitions of mining, agricultural and construction equipment in Article I(2)(a), (b) and (k) is that it covers accessories "*which do not fall within a separate HS code listed in that Annex*". The purpose of this language is to clarify that the connection of one piece of MAC equipment covered by an HS code listed in the Annexes (such as a tractor) with another piece of MAC equipment covered by a different HS code listed in the Annexes (such as a harvester) would not allow one international interest to encumber both objects.

101. The classification of parts under the HS is somewhat complex. Generally, parts for use solely or principally with particular machines are classified in the same code unless the notes of the relevant chapter provide otherwise. For goods of Section XVI (which covers all equipment in Chapter 84 and, therefore, 31³⁷ of the HS codes listed in the draft MAC Protocol annexes), parts are classified under the legal provisions of Note 2 to Section XVI. This Note excludes any goods that are ruled out by the respective Note 1 in the Section, as well as Note 1 to Chapter 84 or Chapter 85. For all other parts, it has three major provisions which are applied hierarchically. First, parts which are also goods of a particular heading in Section XVI are classified in those headings. This means that goods, such as engines, electric motors, valves, pumps and so on, that have their own classification in the Section are classified there and not classified in any parts heading or with their parent goods. Second, other parts which are suitable for use solely or principally with particular machines are classified in the same heading as those machines or in the appropriate dedicated parts heading for those goods if there is one. Finally, remaining parts which are for a wide range of goods are classified in residual headings.

102. The Explanatory Notes for Section XV (which covers Chapter 82) and, therefore, 1 HS code listed in the draft MAC Protocol annexes) provides that, in general, identifiable parts are classified as such parts in their appropriate headings in the nomenclature; Section XV Note 2 defines certain goods as "parts of a general use", regardless of whether they are specialised. These are various common parts such as bolts, springs, cables etc. and, when presented separately, they are classified in their respective headings in Section XV and never as parts.

³⁷ Including the additional HS codes proposed by States in 2018 and subject to a positive recommendation from the Secretariat, there are 45 HS codes under Chapter 84 that could be listed in the MAC Protocol Annexes.

103. The Notes to Section XVII (which covers Chapter 87 and, therefore, 10 HS codes listed in the draft MAC Protocol annexes) provides that references to “parts” or “accessories” in Chapter 87 do not apply to parts or accessories which are not suitable for use solely or principally with the articles of that Chapter. They also give a wide range of exclusions, including excluding many goods classifiable in Chapters 84, 85 and 90 from being considered as parts (e.g., engines, motors, heating equipment, electrical or electronic components and so on).

104. In selecting HS codes for inclusion in the draft MAC Protocol Annexes, HS codes specifically covering only parts were excluded. Through a combination of the definition of MAC equipment, the Interpretative Rules on parts under the HS and the decision not to list HS codes covering parts in the Annexes, parts are not capable of being subject to an international interest under the MAC Protocol and will be covered by the international interest over the principle object (e.g., a tractor’s wheels will be covered by an international interest over the tractor). However, as explained above, accessories (or implements) that are uniquely identifiable equipment falling within another HS code listed in the MAC Protocol Annexes are capable of being subject to an international interest that may be registered separately in the International Registry.

Accessions and installations under Article 29(7) of the Cape Town Convention

105. Article 29 of the Convention deals with the priority of competing interests. Paragraph 7 of Article 29 provides:

This Convention:

(a) *does not affect the rights of a person in an item, other than an object, held prior to its installation on an object if under the applicable law those rights continue to exist after the installation; and*

(b) *does not prevent the creation of rights in an item, other than an object, which has previously been installed on an object where under the applicable law those rights are created.*

106. Article 29(7) defers to the applicable national law to determine how to treat installations on objects encumbered by an international interest under the Cape Town Convention. Under this Article, deferring to the applicable law for items does not affect the priority of the international interest over the object itself. Paragraph 7(a) deals with the installation of an item which is not covered by the Convention (such as a computer or spare part) on an object which is covered by the Convention. It provides that installation or incorporation does not affect pre-existing rights if they are preserved by applicable law. Alternatively, if the applicable law provides that the right to the installed or incorporated item passes under the doctrine of accession to the owner of the object as the principal asset, then the pre-existing right will be extinguished.³⁸ Paragraph 7(b) states that where the applicable law so provides, rights in items which have previously been installed may be created in them after their removal from the object.

107. The MAC Protocol does not disturb these rules. As such, interests in items installed upon MAC equipment will continue to be governed by the domestic law in MAC Protocol Contracting States.

³⁸ Aircraft Protocol Official Commentary (4th edition 2019), paragraph 4.206.

PART 4 – ISSUES RELATED TO INSOLVENCY AND ENFORCEMENT

K. Insolvency alternatives

108. Previous Protocols to the Cape Town Convention allow Contracting States to select the insolvency remedies to apply in relation to the enforcement of international interests under the Convention against a party which is insolvent. Alternative A (considered to be the “hard” or rule-based option that strengthens the position of the creditor)³⁹ allows expedited remedies for parties holding international interests. Alternative B (considered to be the “soft” or discretion-based option that favours the position of the debtor)⁴⁰ allows for a more significant role for the court in the insolvency proceedings. All three previous Protocols to the Cape Town Convention contain Alternatives A and B. The Luxembourg Rail Protocol additionally includes Alternative C, which was added as an alternative that better reflects the insolvency law that currently exists in some European Union member states. Alternatively, Contracting States are permitted not to elect any of the alternatives, in which case their domestic insolvency law applies.

109. Given that Alternatives A and B are included in all three previous Protocols, it appears reasonable for them to be included in the draft MAC Protocol as well. The Study Group and Committee of Governmental Experts was also supportive of including Alternative C, on the basis that it takes into account the Continental European approach to insolvency.

110. Alternative C features only in the Luxembourg Rail Protocol, and was designed as a compromise between Alternatives A and B. As in Alternative A, the obligation of the insolvency administrator under Alternative C is triggered by the occurrence of an insolvency-related event (*i.e.* with no need for a request from the creditor). As consistent with Alternative B, Alternative C requires the administrator to either cure all defaults or provide the creditor with the “opportunity” to take possession “in accordance with the applicable law” within a specified period. However, the administrator can defer the obligation for such time as the court orders (but no later than when the underlying agreement would have expired), provided that sums accruing to the creditor during the suspension period are paid, and the rolling stock and its value are maintained. After the expiration of the cure or the further suspension period, where ordered, the exercise of the default remedies available to the creditor under the Convention and Protocols can no longer be prevented or delayed, as consistent with Alternative A. This provision requires the displacement (from the end of the cure period or further suspension period) of procedural restrictions, such as a stay, that could otherwise bar the exercise of default remedies in insolvency. As such, the core difference between Alternative A and Alternative C is the possibility of delays in the exercise of default remedies under Alternative C where a suspension order is made.⁴¹

111. As a matter of policy, there is benefit in giving Contracting States the widest variety of options in selecting insolvency remedies, as long as they remain consistent with the approaches in the previous Protocols. As such, Article X of the draft MAC Protocol includes Alternatives A, B and C, as consistent with the approach in the Luxembourg Rail Protocol.

112. Due to the relative similarity in the nature of aircraft and space objects, the Space Protocol adopted the policy approach of the Aircraft Protocol in providing only insolvency Alternatives A and B (as opposed to those in the Luxembourg Rail Protocol).

³⁹ Aircraft Protocol Official Commentary (4th edition 2019), paragraph 3.126.

⁴⁰ Aircraft Protocol Official Commentary (4th edition 2019), paragraph 3.134.

⁴¹ Kristin Van Zwieten, ‘The Insolvency Provisions of the Cape Town Convention and Protocols: Historical and Economic Perspectives’, *Cape Town Convention Journal* (2012) Volume 1, page 69.

L. Special insolvency regimes affecting farmers and agricultural enterprises

113. During Study Group negotiations, a research paper was prepared on specialised insolvency regimes that could apply to farmers (the research paper provided to the Study Group is available at Appendix III). The research revealed that there were certain specialised insolvency regimes that could apply to farmers. Domestic laws generally tended to give farmers certain rights as opposed to other insolvent debtors. Furthermore, in some jurisdictions, certain agricultural machinery could be exempted from repossession, certain assets could be protected as part of the protection of the farmers' ownership in the land itself, and certain actions taken by creditors could be suspended, and under some regimes farmers also have access to special funds to restructure their business. Most legal mechanisms protecting farmers and agricultural enterprises primarily targeted individual and family farmers, which would exclude economically high value equipment as small-scale farmers would not generally own such equipment. The research paper concluded that there wouldn't be any need for additional alternatives as the transactions covered by the special domestic insolvency regimes would generally be outside the scope of the draft MAC Protocol.

114. The Study Group discussed whether an additional Article based on either Article XXV (the public service railway exemption) of the Luxembourg Rail Protocol or Article 40 (registrable non-consensual rights or interests) of the Cape Town Convention could be drafted in this respect. It would operate to the effect that where there was a conflict between the existing national law and insolvency remedies under the draft MAC Protocol, then the State could declare that they uphold their current domestic legislation. Under the Article 40 approach, States would be required to specifically provide information about how their declaration would affect rights under the Convention and draft MAC Protocol. It was noted that while the drafting of Article XXV of the Luxembourg Rail Protocol might be a useful model, it would be important to distinguish that issue from the public service provision in the Luxembourg Rail Protocol, as the inclusion of such an article could cause significant controversy.

115. Ultimately the Study Group decided that the current options under the draft MAC Protocol should be left as they were and any exclusive exceptions for the agricultural sector should not be included.

116. The Study Group also discussed whether to allow Contracting States to apply different insolvency alternatives to different draft MAC Protocol Annexes. The rationale behind giving States this additional flexibility was to allow them to preserve the application of special insolvency regimes in the agriculture sector by not making a declaration in relation to Annex 2 (and thus allowing national insolvency law to apply) but still making declarations under Article X in relation to Annexes 1 or 3. The draft Article (Article X - Remedies on Insolvency, paragraph 3) in the fifth Study Group draft provided that where a Contracting State declared the application of different Alternatives to different Annexes, a Contracting State had to also declare which Alternative applied to HS codes contained in more than one Annex. This mandatory requirement aimed at removing any potential uncertainty in relation to which insolvency regime applied to a certain piece of MAC equipment.

117. Upon further discussion at the fourth Study Group meeting, it was decided to drop the provision allowing Contracting States to apply different insolvency regimes to different Annexes to the draft MAC Protocol. It was considered to be an unnecessary complexity. During CGE1, the Committee reaffirmed this approach and inserted paragraph 4 into Article XXVI of the draft MAC Protocol, to clarify that declarations made in relation to immovable property (Article VII) and insolvency remedies (Article X) cannot be made on an Annex-by-Annex basis by Contracting States. As such, under the current drafting, a Contracting State cannot make a declaration that, for instance, Article X Alternative A would apply to Agricultural Equipment under Annex 1, but Article X Alternative B would apply to Construction Equipment under Annex 2 and Mining Equipment under Annex 3.

M. Restrictions on the enforcement of security interests in agricultural equipment

118. During Study Group negotiations, a comparative analysis was prepared on domestic restrictions on the enforcement of security interests in agricultural equipment (the research paper provided to the Study Group is available at Appendix IV of this Legal Analysis).

119. The report noted that laws which imposed certain limitations on enforcement rights were typically found in legislation separate from the secured transactions regimes, such as in Australia, Canada and the USA. Some transaction-specific secured transactions laws, such as in Kenya and Nigeria, explicitly included such limitations. However, in the context of the latter two countries, it was noted that their secured transactions regimes were subject to current IFC secured transaction reform projects, and laws in both Kenya and Nigeria were reformed in 2017. It was further explained that certain States and Provinces in Australia, Canada and the USA had adopted laws which required mediation of farmer debts which would essentially delay the enforcement of secured creditors' rights. The farmer had the right to initiate mediation in order to attempt to settle a debt whereby the enforcement process was suspended, typically for a period of thirty days. If the mediation was unsuccessful, the creditor's rights could then be enforced under the relevant law. Mexico had a unique approach. Typically, exemption laws would protect assets only against judgement creditors.⁴² Yet in Mexico, there was a peculiar situation, namely estate exemption, which allowed a family farmer to exempt certain farming machinery even against secured creditors. For that exemption to take effect, however, public registration was a pre-requisite. Therefore, a creditor essentially would be in a position to know beforehand that a certain asset might not be subject to enforcement.

120. The comparative analysis also considered the 11 submissions received from UNIDROIT Correspondents. Most jurisdictions did not have any specific protection for farmers and agricultural equipment, except for Hungary, Japan and Turkey. In Hungary, there was a closed list of farmer definitions whereby based on eligibility criteria, an individual would be exempt from enforcement measures of secured creditors. Excluding agri-businesses and large-scale agricultural enterprises, the Turkish legislation provided for special legal protection for farmers, provided that such equipment was deemed essential for the sustenance of the debtor farmer and his family. The Japanese approach, on the other hand, provided for exemption from seizure for 'indispensable equipment' for the agricultural sector subject to certain conditions. Under the Japanese protections, agricultural equipment was only protected against actual seizure, whereas transfer of such equipment was not prohibited.

121. During Study Group discussions it was noted by the IFC that in emerging markets where it had been working to reform secured transactions laws, no opposition from the agricultural sector had been encountered thus far in relation to the application of insolvency or enforcement regimes to agricultural equipment. The IFC reiterated that in the case of small-scale individual farmers as well as family farmers which governments were aiming to protect, it would be unlikely that high-value machinery would be involved.

122. Ultimately, the Study Group concluded that there was no need for the inclusion of a specific article in the draft MAC Protocol in relation to restrictions on the enforcement of international interests in agricultural equipment. The Committee of Governmental Experts made no changes to the Study Group's approach.

⁴² A judgment creditor is a party that is entitled to use judicial process to collect the debt.

PART 5 – ISSUES RELATED TO REGISTRATION

N. Interaction with domestic secured transactions regimes

123. Assets covered by the Cape Town Convention and its Protocols are typically excluded from general domestic secured transactions regimes, as consistent with article 1(3)(e) of the UNCITRAL Model Law on Secured Transactions. However, when such assets are covered by a domestic regime that provides for the creation and registration of domestic interests in that equipment, there is a potential overlap between such domestic interests under the national laws and an international interest under the Cape Town system. To resolve this potential overlap, Article 29 of the Cape Town Convention provides that the international interest takes priority.

124. The Study Group and Committee of Governmental Experts affirmed that interests registered under the future MAC Protocol should have priority over those interests made effective under national laws, as consistent with the previous Protocols.

O. Registration of interests in MAC equipment in domestic registries

125. During Study Group negotiations, a research report was prepared on the registration of interests in MAC equipment in national registries (the research paper provided to the Study Group is available at Appendix V of this Legal Analysis).

126. The report noted that the registration of ownership of MAC equipment in national registries was possible in several jurisdictions, however only in limited circumstances. The laws that typically govern the registration of ownership had different scopes of application depending on the classification of the asset in question. It explained that the definition of “motor vehicle” may be relevant for this purpose as it could encompass some types of MAC equipment (e.g., tractors). Other than motor vehicles, some States also provide for a category of “specialised vehicles” in respect of which ownership may be registered. The paper also noted that in the United States, for instance in Arizona and Texas, the registering authorities were given the power to issue serial numbers.

127. Further, in certain circumstances domestic registries did issue “transfer statements” through which a secured creditor would be empowered to submit a statement to the department of motor vehicles, transferring ownership of the vehicle to the transferee or the buyer who bought it at a foreclosure sale. In such jurisdictions, ownership of MAC equipment may be registered in the domestic registry. However, these limited circumstances do not appear to warrant a specific rule in the MAC Protocol reflecting the Immediate Deregistration and Export Request Authorisation (IDERA) provision as set forth in Article XIII of the Aircraft Protocol.

128. The Study Group supported the inclusion of a straightforward and simple obligation for Contracting States to cooperate with creditors when they realise their enforcement rights in the form of a cooperation provision, instead of trying to come up with a precise obligation. It was agreed that Article VII(5) of the Luxembourg Rail Protocol would be sufficient in this context for incorporation in the draft MAC Protocol. Further analysis on the role of administrative authorities under the draft MAC Protocol is available in Part 6R of this Legal Analysis.

P. Registration and search criteria

129. Articles XVII and XVIII(1) of the draft MAC Protocol establish the criteria for the registration and searching for equipment in the future International Registry. These provisions were adopted by

the Committee of Governmental Experts at its second session, on recommendation from the Intersessional Working Group on Registration Criteria (IWGRC).⁴³

Article XVI – Identification of agricultural, construction or mining equipment for registration purposes

A description of agricultural, construction or mining equipment that contains its manufacturer's serial number and such additional information as required to ensure uniqueness is necessary and sufficient to identify the object for the purposes of Article 18(1)(a) of the Convention. The Regulations shall specify the format of the manufacturer's serial number and provide what additional information is required to ensure uniqueness.

130. Article XVI provides that the process of registration requires two types of information: first, the registering person must identify the MAC equipment by indicating its manufacturer's serial number that is typically to be found on a serial number plaque permanently affixed to the equipment. Additionally, the registering person must also indicate other additional information concerning the equipment as required to ensure uniqueness in accordance with the Regulations. No registration can be affected without this information being indicated by the registering person.

131. The selection of appropriate categories of mandatory additional information in the future Regulations should ensure that the registration process is kept simple and that the additional information can both guarantee the uniqueness of the identification of the MAC equipment and serve the transparency objectives and the informative value of a registration in the International Registry. The effectiveness of the registration in regards to the registering person's international interest depends upon the correct indication of the manufacturer's serial number, but trivial errors concerning the other additional information do not affect the effectiveness of the registration.

132. In contrast to the Aircraft Protocol, the MAC Protocol does not use the manufacturer's name as a registration criterion. Primarily, this is because manufacturers of MAC equipment operate under different trading names, often using the names of local subsidiaries or other corporate designations. This practice, combined with the much higher number of MAC manufacturers operating globally (as compared to the relatively small number of aircraft manufacturers) would make it challenging for a registering party to easily obtain the exact legal name of the manufacturer.⁴⁴

Article XVII – Additional modifications to Registry provisions

1. *For the purposes of Article 19(6) of the Convention, the search criterion for agricultural, construction or mining equipment shall be its manufacturer's serial number.*

133. Article XVII(1) provides that when searching the International Registry, the single search criterion will be the manufacturer's serial number. A search might yield several results where there are multiple registrations referring to different pieces of MAC equipment with identical serial numbers. These would be rare occurrences, but could still occur due to the lack of universally agreed standards as to the unique allocation of manufacturers' serial numbers. Under Article 22(2)(a) of the Convention, a search certificate is issued by the Registrar in respect of each search result, stating all registered information relating thereto, i.e. including both the manufacturer's serial number and the other additional information registered in accordance with the requirements of Article XVI. In situations where searching the International Registry for a specific serial number has yielded several

⁴³ The report of the IWGRC submitted to CGE2 in September 2017 is available at: <https://www.unidroit.org/english/documents/2017/study72k/cqe02/s-72k-cqe02-11-e.pdf>.

⁴⁴ IWGRC Report (September 2017), paragraphs 17 – 19, available <https://www.unidroit.org/english/documents/2017/study72k/cqe02/s-72k-cqe02-11-e.pdf>.

results (i.e. where the manufacturer's serial number in itself did not provide the uniqueness of the registration), searching parties can use the additional information to determine which of the several registrations, if any, refers to the piece of MAC equipment which they are interested in.

134. Article XV(1) of the Luxembourg Rail Protocol provides that the criteria for searching the International Registry will be established by the regulations. Section 8.1 of the baseline regulations for the Rail Protocol International Registry then state that searches shall be made using only the manufacturer's serial number. As such, in effect, Article XVII(1) of the draft MAC Protocol is substantively consistent with Article XV(1) of the Luxembourg Rail Protocol, however the Luxembourg Rail Protocol defers the substantive rule to the Regulations to provide additional flexibility.

Q. Designated Entry Points

135. Article XVI allows Contracting States to designate a domestic entry point through which information required for registration shall or may be transmitted to the International Registry. Contracting States are able to designate a mandatory domestic entry point for the transmission of information associated with the registration of an international interest, but can only designate a non-mandatory domestic entry point for information required for the registration in respect of notices of sale.

136. At CGE2, Article XVI was the subject of significant debate.⁴⁵ Some delegations favoured the removal of Article XVI on the basis that in contrast to the aviation sector, it was unlikely that there would be one single national authority with responsibility for MAC equipment that could be designated as a domestic entry point. Other delegations queried whether deletion of Article XV was necessary, on the basis that it was not a compulsory Article and did not impose an obligation on Contracting States. A number of delegations also noted that the Article had been included in all three previous Protocols to the Cape Town Convention, and suggested that it should be retained to maintain consistency with the previous Protocols. Other delegations suggested that should Article XVI be retained, either the Convention or Regulations needed to identify the connecting factor that would determine whether a party was obliged to use a designated entry point in registering an interest in the International Registry. Ultimately, CGE2 decided to retain Article XVI in square brackets, for further consideration at the Diplomatic Conference.

137. On the basis that Article XVI is a non-mandatory provision (it only applies to Contracting States that make a declaration nominating a domestic entry point), assists in linking the International Registry to domestic registries and is desired by some negotiating States, it is suggested that the provision be retained. However, the Diplomatic Conference may wish to give further consideration to this matter.

Connecting Factor

138. Under the Aircraft Protocol, the connecting factor is the national registry in which the aircraft is registered. Though Article XIX does not specify which Contracting State may make the declaration, the designation of an entry point will have an impact only in relation to aircraft objects for which the declaring State is the State of registry for the purposes of the Chicago Convention, for only that State has the requisite control. Accordingly Section 12.2(a) of the Regulations specifies that a Contracting State may designate a mandatory entry point only in respect of registrations relating to airframes and helicopters of which it is the State of registry and registrations of prospective international

⁴⁵ UNIDROIT 2017 – Study 72K – CGE2 – Report, paragraphs 124 – 134, available <https://www.unidroit.org/english/documents/2017/study72k/cqe02/s-72k-cqe02-report-e.pdf>.

interests, prospective sales or prospective assignments of international interests in any airframe or helicopter for which it has taken regulatory steps to become the State of registry.⁴⁶

139. As consistent with the Aircraft Protocol and Luxembourg Rail Protocol, it is suggested that the connecting factor in relation to domestic entry points be established by the regulations. During CGE2, several delegations suggested that the connecting factor should be the debtor's location (i.e. if a debtor is located in a Contracting State that has mandated the use of a designated domestic entry point, then it must use that entry point). Complications may arise where a debtor is situated in multiple locations in different Contracting States that have all designated a mandatory entry point. In such a situation, it would be expected that the debtor should use the entry point most closely associated with the transaction (e.g. the State in which the equipment is likely to be used, at least initially). However, nothing would prevent the debtor utilising another entry point, should it also be "situated" in that State under Article 4 of the Convention.

140. Another option would be for the regulations to establish that the connecting factor is the location of the equipment at the time of creation or registration of the international interest, which would prevent the possibility of multiple entry points. However, such an approach would also cause problems where the equipment was located in a non-Contracting State before its export or transfer for use in a Contracting State.

141. The Diplomatic Conference may wish to further discuss which connecting factor might be most appropriate to be set out in the future regulations for the MAC Protocol International Registry.

⁴⁶ Aircraft Protocol Official Commentary para 3.64.

PART 6 – OTHER ISSUES

R. Administrative Authorities

142. Article VIII(5), Article IX(6), Article X Alternative A (8), and Article X Alternative C (9) of the draft MAC Protocol contain references to “administrative authorities” in the context of requiring their assistance in the enforcement of a creditor’s right to procure the export and physical transfer of MAC equipment. These provisions impose an obligation on Contracting States, subject to any applicable safety laws and regulations, to ensure that such authorities expeditiously cooperate with and assist the creditor in procuring export and physical transfer of a MAC object.

143. The remedies of export and physical transfer may be exercised through one of two routes, either pursuant to a court order or extra-judicially. Exercise of these remedies under Article VIII is not dependent on a court order, but requires the satisfaction of the requirements prescribed in that Article (out-of-court route).⁴⁷ To exercise these remedies under Article IX(6), the Contracting State must have made a declaration under Article XXVII(2) applying Article IX and the creditor must have obtained relief pending final determination under Article 13 of the Convention (court route).⁴⁸ Finally, these remedies may be enforced in insolvency only if the relevant Contracting State has made a declaration applying either Alternative A or Alternative C. Article VIII requires expeditious cooperation with and assistance to the creditor to the extent necessary, whereas Article IX and Article X, in addition require the administrative authorities to make the remedies available no later than seven calendar days after receipt of a notification.

144. Consensus was not reached at CGE2 on whether to retain the provisions referring to administrative authorities.⁴⁹ Some States favoured retention of the existing provisions on the basis that the assistance of administrative authorities in the physical transfer and export of equipment was required in both the Aircraft and Luxembourg Rail Protocols and that the removal of the paragraph would have the implication that administrative authorities of the Contracting States were not required to assist creditors under the MAC Protocol to the same extent they were required to assist creditors under the earlier Protocols. Other States favoured deletion of the relevant provisions on the basis that they lacked clarity in relation to the obligations imposed on Contracting States and could complicate the implementation of the Convention, particularly for Federal States.

145. To find a compromise solution, several States proposed alternative drafting, aimed at providing a more precise but not exclusive definition of administrative authorities and giving States the option to opt-out of the provision. Neither compromise solution received enough support to be adopted. As no consensus was reached, the relevant provisions were placed in square brackets, with the additional sub-bracketed phrase “including but not limited to tax and custom authorities and transport infrastructure authorities”.

Definition of Administrative Authorities

146. Under the MAC Protocol, there are a large number of potential “administrative authorities” which could be required to provide assistance to creditors:

- Federal and State Departments of Transportation (DOT): As the process of moving MAC equipment may involve transporting such equipment to the relevant ports, sometimes involving the crossing of state lines or use of federal highways, which may require an authorization from the DOT. The DOT rules affected by transfer of MAC

⁴⁷ Luxembourg Rail Protocol Official Commentary (2nd edition 2014), paragraph 3.25.

⁴⁸ Luxembourg Rail Protocol Official Commentary (2nd edition 2014), paragraphs 5.20 – 5.26.

⁴⁹ UNIDROIT 2017 – Study 72K - CGE2 - Report, paragraphs 92 – 107, available <https://www.unidroit.org/english/documents/2017/study72k/cqe02/s-72k-cqe02-report-e.pdf>.

equipment include road usage by certain heavy vehicles, road safety regulations, and so on.

- Highway Traffic Safety Administration: These authorities may permit or block the importation or movement of vehicles that may include some MAC equipment like dump trucks.
- Motor Vehicle Registration Offices/State or Municipal Departments of Transports/ Departments of Motor Vehicles: These authorities issue license plates to vehicles, including to some commercial vehicles (e.g. trucks, trailers, tractors, and bulldozers). The secured creditor may need to transfer title to the equipment to itself and obtain new plates, or may need to obtain special permits in order to move MAC equipment through state roads or municipal roads.
- Maritime Administration and Port Authorities: These entities are responsible for waterborne transportation. Since MAC equipment will most likely be moved by sea, the prompt co-operation of these authorities may be necessary, in particular to obtain a docking permit.
- State or Municipal Authorities e.g. Department or Ministries of Buildings, Construction or Infrastructure, Parking Departments: Permits may be required from municipal parking authorities to reserve a loading zone in order to load or unload the heavy equipment. Building or construction departments may be responsible for issuing permits for erecting, assembling, disassembling, or using certain equipment.
- Tax and Customs Authorities: Local laws may demand export licenses for the removal of certain MAC equipment.

147. It does not appear possible to identify all possible relevant authorities that could be involved in the export and physical transfer of MAC equipment. On this basis, it is suggested that the relevant provisions in the draft MAC Protocol should not try to identify them and instead this could be left to the Official Commentary.

Consistency with existing Protocols

148. Reflecting upon existing practice under the Aircraft Protocol, there may not be a demonstrated problem in relation to the interpretation of “administrative authorities”. The Aircraft Protocol covers both equipment that is subject to national registration (e.g. Airframes) and equipment that is not subject to national registration (i.e. Engines). Article IX(1) of the Aircraft Protocol contains a remedy for the deregistration of equipment that is subject to national registration and a separate remedy of export and physical transfer for equipment that is both subject to national registration and equipment that is not subject to national registration.⁵⁰ This separate remedy of export and physical transfer applies to “uninstalled engines”. Thus, the term “administrative authorities” as used in Articles X and XI of the Aircraft Protocol is intended to apply to administrative authorities (whomever they may be) with authority over the export and physical transfer of uninstalled engines.⁵¹

149. On the basis of retaining consistency with the existing Protocols, the MAC Working Group has noted that it opposes the deletion of the “administrative authorities” provisions in the Protocol. The MAC Working Group has advised that without this general reference to applicable administrative authorities in Article IX of the draft MAC Protocol, the remedy for the export and physical transfer of MAC equipment could be subverted in an interim speedy relief context by an administrative authority

⁵⁰ Aircraft Protocol Official Commentary (4th edition 2019), paragraphs 3.31 – 3.37.

⁵¹ Aircraft Protocol Official Commentary (4th edition 2019), paragraph 3.16: “Aircraft engines are not subject to national registration, so that the aircraft registry authorities have no relevance to them, and the only administrative authorities involved with regard to engines are those concerned with export and imports.” A common example of such an administrative authority would be the customs authorities of a Contracting State.

failing to act within a defined time period. Similarly, the stay in an insolvency context under Article X could be de facto extended if the applicable administrative authority failed to act.

150. The draft MAC Protocol reflects the same approach on this issue as the Aircraft Protocol (in relation to engines) and Luxembourg Rail Protocol (in relation to all objects). The Aviation Working Group advises that the references to “registry authority and other administrative authorities” have not resulted in ratification issues in the Aircraft Protocol context. Further, the seven calendar day timeframe for administrative authorities to assist creditors with the export and physical transfer of engines under the Aircraft Protocol has not caused any problems in practice. While there may be additional administrative authorities involved in the MAC Protocol context, given the similar concerns regarding the availability of the remedy of export and physical transfer, including in a speedy relief and insolvency context, it is suggested that the use of the term “administrative authorities” in the draft MAC Protocol should not deviate from the approach adopted in the previous Protocols. This approach has not raised concerns in relation to the seventy-six States that have adopted the Aircraft Protocol.⁵²

151. Further guidance on the interpretation of “administrative authorities” could be provided in the Official Commentary to the future MAC Protocol.

S. Application to sales

152. The previous Protocols to the Cape Town Convention differ in their treatment of sales of the types of equipment they cover. The Aircraft Protocol and Space Protocol apply to sales and allow a sale to be registered in the International Registry, as this reflects existing commercial practices in these industries. The Luxembourg Rail Protocol provides for the registration of notices of sale in the International Registry, which have no substantive legal effect under the Protocol itself, but may affect interests under domestic law.

153. The Official Commentary to the Luxembourg Rail Protocol provides the following analysis of Article XVII of the Luxembourg Rail Protocol governing notices of sale:

5.70: ...Article XVII of the Luxembourg Protocol, allowing registration of notices of sale, provides that any such registration and any search made or certificate issued is to be for information purposes only and is not to have effects under the Convention or Protocol. The sole purpose of the registration facility is to give notice of the sale transaction with a view to securing a priority under national law. It is, of course, for the applicable law to determine whether a voluntary registration in the International Registry has any significance in the application of its priority rules.

154. During Study Group negotiations, a research report was prepared on the effect of notices of sale under domestic law regimes (the research paper provided to the Study Group is available at Appendix VI of this Legal Analysis).

155. The report explains that there are two limited circumstances under which the registration of a notice of sale may affect the rights of parties, both relating to the conflict between a first buyer and a subsequent buyer. The report then considers the possible legal effects of the registration of a notice of sale in seven different countries. Generally, the notice of sale is likely to have effect on the rights of the parties in legal regimes which require the secondary buyer to act in good faith. The report concludes that the registration of a notice of sale would not affect the rights of parties in Colombia, but might affect their rights in France, Germany, Mexico, Spain, the United Kingdom and the United States.

⁵² As at 30 June 2019.

156. At its fourth meeting, the Study Group decided that the draft MAC Protocol should adopt the Luxembourg Rail Protocol approach of allowing the registration of notices of sale. In making this decision, the Study Group noted that not inserting such an article would constitute a further deviation from the previous Protocols (which either allowed the registration of notices of sales without any substantive effect, or required such registrations for the purposes of applying the priority rules). The Committee of Governmental Experts affirmed this approach.

157. Article XIX (Notices of Sale) of the draft MAC Protocol reflects the approach of the Luxembourg Rail Protocol.

T. Short-term leases

158. As provided by Article 2(2)(c) of the Convention, leasing agreements can create international interests in equipment under the various Protocols. Under the Aircraft Protocol, Luxembourg Rail Protocol, Space Protocol and draft MAC Protocol, international interests can be constituted by leasing agreements, regardless of the length of the lease.

159. To protect its interest in the equipment, a lessor would need to register its international interest in the registry (Article 29(1)). A lessor's unregistered international interest would remain vulnerable to a conflicting international interest of a buyer, conditional buyer, or sub-lessee from the lessee. Article 29(3)(b) and (4)(b) further provides that a buyer, conditional buyer, or lessee would take free of an unregistered interest.

160. For the MAC leasing industry, treating short-term leases as agreements capable of constituting registerable international interests may create additional costs (such as registration expenses and possibly legal expenses). In many jurisdictions, leasing arrangements are not subject to any registration, filing, or similar requirements for protection of a lessor's ownership against third party interests. In such States, the MAC Protocol may require a change in practice for the leasing industry.

161. However, by applying the Protocol to all leases regardless of their length, lessors will gain the additional benefits provided to the holders of registered international interests under the Convention. Further, such an approach remains consistent with the existing Protocols. Aircraft are commonly subject to short-term leasing agreements, and the Aircraft Protocol's application to such agreements has not caused any significant problems for the industry. Aviation leasing experts have reported that whether an international interest created by a short-term leasing agreement is registered in the international registry will usually depend on the relationship between the lessor and the lessee.

162. On this basis, it is not recommended that the draft MAC Protocol include a provision limiting its application to short-term leases. It should be noted that Article XI(1) provides for the application of domestic law take-free rules for lessees of inventory from dealers, rather than the Convention take-free rules under Articles 29(3)(a) and (4)(a).

U. Interaction between Article 29(3)(b) and the draft MAC Protocol

163. Article 29(3) of the Convention does not intend to deal with the situation of competing buyers, and should not be read to infer that a secondary buyer should acquire an interest free from a previously unregistered interest of a first buyer.

164. Article 29 (priority of competing interests) provides the following:

3. *The buyer of an object acquires an interest in it:*

- (a) *subject to an interest registered at the time of its acquisition of that interest;*
and
- (b) *free from an unregistered interest even if it has actual knowledge of such an interest.*

165. The Study Group noted that there was no conflict between Article XVII (notices of sale) of the Luxembourg Rail Protocol and Article 29(3) of the Cape Town Convention, as the buyer's position is not protected under the Luxembourg Rail Protocol, and Article XVII of the Luxembourg Rail Protocol was not meant to prevail or otherwise interact with Article 29(3). As Article XIX of the draft MAC Protocol adopts the same approach as the Luxembourg Rail Protocol to notices of sale, the same conclusion should be reached in relation to the relationship between the draft MAC Protocol and Article 29(3) of the Convention.

166. The Official Commentary to the Luxembourg Rail Protocol provides the following explanation of Article 29(3):

4.186. Paragraph 3 introduces the first of two exceptions to the general rule that even an unregistrable interest is displaced by a subsequent registered interest. The case of purchase by an outright buyer is considered so common and important as to justify a special rule giving the buyer's interest priority over an interest not registered until after the time of the buyer's acquisition of the object. However, it is an implicit condition of the application of Article 29(3) that the seller had a power to dispose of the object. Where the buyer acquires priority under this rule, the effect is to extinguish any unregistered security interest in the object, and where the international interest was in respect of a conditional sale or leasing agreement, any title of the conditional seller or lessor whose interest was unregistered, since its displaced interest is not as conditional seller or lessor but simply whatever interest it had at the time of entering into the conditional sale or leasing agreement.

167. This paragraph is illustrated at page 309 of the Official Commentary in the following way:

O, the owner of a locomotive, leases it to L. Before O has registered its interest, L wrongfully sells the locomotive to B. B displaces O as the owner, and this is so even if B knew of O's international interest.

168. In the above illustration, it is understood that O's 'international interest' is an internationally registrable interest that has not been registered.

169. As the Aircraft and Space Protocols allow for the registration of the interest of an outright buyer, Article 29(3) of the Convention is replaced by Article XIV(1) and (2) of the Aircraft Protocol and Article XXIII of the Space Protocol, which provide:

Modification of priority provisions

- 1. The buyer of an [aircraft object/space asset] under a registered sale acquires its interest in that asset free from an interest subsequently registered and from an unregistered interest, even if the buyer has actual knowledge of the unregistered interest.*
- 2. The buyer of an [aircraft object/space asset] under a registered sale acquires its interest in that asset subject to an interest previously registered.*

170. During its deliberations, the Study Group decided that Article 29(3) did not intend to deal with the situation of competing buyers, and that it should not be read to infer that a secondary buyer should acquire an interest free from a previously unregistered interest of a first buyer. The Study Group decided that there was no need to insert an Article in the draft MAC Protocol on this issue,

however the future Official Commentary to the MAC Protocol should expressly provide that Article 29(3) would not apply to situations involving competing buyers.

V. Modification of assignment provisions

171. The MAC Protocol follows the precedent in the Luxembourg Rail Protocol and does not modify the original assignment provisions in the Convention.

172. The Study Group discussed whether it was necessary for the draft MAC Protocol to modify the assignment provisions in the Cape Town Convention, as consistent with Article XV of the Aircraft Protocol and Article XXIV of the Space Protocol. It was noted that Article XV of the Aircraft Protocol modified Article 33 of the Cape Town Convention, by adding the additional requirement of obtaining a debtor's consent in writing before an assignee may enforce the debtor's duty to make payment or perform other obligation. It was further noted that this additional requirement was included in the Aircraft Protocol because it reflected the established practice in aircraft financing and that the airline industry did not want to have it removed. The Luxembourg Rail Protocol did not follow this approach as such a practice was not followed in the rail industry. It was ultimately concluded that the MAC Protocol should follow the Luxembourg Rail Protocol in this respect.

W. Public service exception

173. Article XXV of the Luxembourg Rail Protocol and Article XXVII of the Space Protocol provide an exemption to the operation of certain aspects of the Cape Town Convention and the relevant Protocols in relation to the provision of public services. While the approach to this issue in the two Protocols is materially different, the underlying policy is the same: the State has a natural interest in ensuring that a creditor exercising its rights under the Convention/Protocol does not cause the abrupt termination of a service of public importance.⁵³

174. Article XXV of the Luxembourg Rail Protocol provides that a Contracting State may, at any time, enter a declaration that it will continue to apply its domestic law in force at the time of the declaration that precludes, suspends or governs the exercise by the creditor of any remedies under the Convention/Protocol in relation to public service railway rolling stock. Article XXV applies to both passenger vehicles and freight vehicles that must be habitually providing a service of public importance (*i.e.* a passenger vehicle habitually carrying a substantial number of passengers on a main line would ordinarily be considered to provide a service of public importance).⁵⁴ If the public service is exercised by the Contracting State, it has duties to preserve and maintain the asset and pay to the creditor compensation under either the national law or the market lease rental within 10 calendar days of taking possession of the asset (and thereafter on the first day of each successive month). There is no time limit on the period the Contracting State can prevent the creditor from exercising a remedy in relation to public service rolling stock.

175. Under Article XXVII of the Space Protocol, a debtor who enters into a contract providing the use of a space asset for public services can agree with other parties to the contract for the provision of the public service and the Contracting State to register a public service notice under the Protocol. Technically, the creditor's consent is not required, as the creditor is not a party to the contract for the provision of public services. However, the creditor can impose contractual restraints on the debtor's consent to registration of a public service notice at the time of the creation of the international interest, and therefore in practice is likely to be a part of the negotiations.⁵⁵ Subject to

⁵³ Space Protocol Official Commentary (1st edition reprint 2014), paragraphs 3.78 – 3.86.

⁵⁴ Luxembourg Rail Protocol Official Commentary (2nd edition, 2014), paragraphs 3.29 – 3.36.

⁵⁵ Space Protocol Official Commentary (1st edition reprint, 2014), paragraph 3.82.

certain exceptions, a creditor may not exercise any Convention/Protocol remedies in the event of a debtor default on an asset that is subject of a public service notice. A Contracting State shall specify by declaration a period of time within which a creditor cannot exercise its remedial rights, however the period of time cannot be less than three months and not more than six months from the time of registration of the notice. During the suspension period, the creditor, debtor and public service provider are required to cooperate in good faith with a view to find a commercially reasonable solution permitting the continuation of the public service.

176. The types of important public services relating to rail transport (carriage of persons and goods) and space assets (national security, transport safety, communications) are obvious. Conversely, the mining, agricultural and construction sectors do not provide public services. Rather, they simply operate in fields which may be of public interest.

177. The first Study Group meeting agreed to adopt a cautious approach to this issue, given the difficulty involved in its negotiation in the previous Protocols. The first Study Group meeting highlighted the important distinction between objects that actually provide a public service covered under the Luxembourg Rail and Space Protocols, and objects that are used in performing functions that are of significant public interest. For example, construction equipment may be used in the building of important infrastructure projects that are central to the public interests of a country; however the construction equipment itself is not providing a continuous public service. It was further noted that the most common types of MAC industry-related projects of national importance would have a degree of public financing and as such would be unlikely to be financed by private financing agreements covered by the Cape Town Convention.

178. The Study Group agreed that it was not necessary to include a public service exception article in the draft MAC Protocol, on the basis that MAC industries do not provide continuous public services. The Committee of Governmental Experts affirmed this decision.

X. Amendment procedures

179. Article XXXIII of the draft MAC Protocol contains two different processes for amending the instrument; paragraphs 2 and 3 provide the rules governing the amendment process for the articles of the Protocols, whereas paragraphs 4 and 5 provide a separate process for amendments to the Annexes. At CGE2, consensus could not be reached on the amendment mechanism for the MAC Protocol or its Annexes.⁵⁶ The Committee tasked the Secretariat to work with interested States to develop an alternative text that was likely to attract wide support from negotiating states.

180. In preparation for the Diplomatic Conference, the Secretariat has undertaken extensive consultations with legal experts and Government stakeholders to develop an alternative amendment proposal. On the basis of these consultations, the Secretariat is proposing that Article XXXIII be redrafted, and a new Article XXXIV be inserted into the Protocol. Background documents providing a detailed explanation of the history of discussions regarding the MAC Protocol amendment mechanisms have been prepared by both the Secretariat and legal experts.⁵⁷

⁵⁶ UNIDROIT 2017 – Study 72K - CGE2 - Report, paragraphs 157 - 163, available <https://www.unidroit.org/english/documents/2017/study72k/cqe02/s-72k-cqe02-report-e.pdf>.

⁵⁷ UNIDROIT 2017 – Study 72K - CGE2 – Doc. 4, pages 35 – 36 and 118 - 122, available <https://www.unidroit.org/english/documents/2017/study72k/cqe02/s-72k-cqe02-04-e.pdf>; Teresa Rodriguez de las Heras Ballell and Megumi Hara, “MAC Protocol and Treaty Design: Examination of the Delimitation of Scope and Mechanism of Amendment” *Cape Town Convention Journal* Vol. 6 (2017) <https://ctcjournal.net/index.php/ctcj/article/view/4>.

Revisions to the HS

181. As explained in Part 2D of this document, the scope of the MAC Protocol is determined solely by the 6-digit HS codes listed in the Protocol's Annexes. The use of HS codes to determine the scope of the MAC Protocol is necessary to limit the instrument's scope to high value, mobile and uniquely identifiable equipment. Article I of the Protocol provides that HS codes for mining equipment are listed in Annex 1, HS codes for agricultural equipment are listed in Annex 2 and HS codes for construction equipment are listed in Annex 3.

182. The HS is amended every five years ("HS revisions"). In general, amendments are made to the HS for three reasons: (i) clarification, (ii) structural reorganisation to reflect changes in international trade flows as influenced by technological developments and evolution in industry practices, and (iii) on the request of international organisations that utilise the HS for various purposes.

183. An HS revision could have the following effects on HS codes listed in the MAC Protocol Annexes:

(iv) (i) An HS code listed in the MAC Protocol Annexes is renumbered or has its heading or subheading changed.

(v) (ii) An HS code listed in the MAC Protocol Annexes is deleted and is split into two or more new HS codes.

(vi) (iii) An HS code listed in the MAC Protocol Annexes is deleted, and the equipment covered by that HS code is added to another HS code listed in the Annexes.

(vii) (iv) An HS code listed in the MAC Protocol Annexes is deleted, and the equipment covered by that HS code is added to an HS code not listed in the Annexes.

184. All of the types of changes described above would require adjustments to the HS codes listed in the MAC Protocol Annexes, to ensure that the listed HS codes remain aligned with the HS.

185. It is vital that the MAC Protocol has a mechanism to take into account HS revisions, because the HS codes listed in the MAC Protocol Annexes entirely determine the instrument's scope. Without such a mechanism, over time the HS codes listed in the MAC Protocol Annexes would become inconsistent with the HS, which would make it difficult for parties looking to create international interests over MAC equipment to verify with certainty what types of equipment are covered by the treaty.

186. For example, if an HS revision taking place in 2027 affects HS codes listed in the MAC Protocol Annexes and the Annexes were not adjusted to reflect the changes, the MAC Protocol Annexes and the HS would no longer be consistent. Parties trying to finance equipment under the MAC Protocol might be confused by the lack of consistency between the HS codes listed in the Annexes and the HS itself. For codes listed in the Annexes that were no longer aligned to the HS, parties would have to try to determine what type of equipment fell under the listed HS code before the new revision entered into force. Over time, this would become increasingly difficult to do. Additional HS revisions in the future would further misalign the MAC Protocol Annexes and the HS, adding to the complexity of trying to determine the exact scope of the MAC Protocol. Any uncertainty in the scope of the MAC Protocol would substantially undermine the operation and effectiveness of the instrument.

187. Overall, HS revisions only tend to impact a small number of the existing codes; new HS editions generally alter 200 – 300 of the approximately 5300 codes (5%). Over 70% of HS codes have never been affected. The Secretariat has conducted research on how the HS codes listed in the draft MAC Protocol Annexes have been affected by the last 4 revisions of the HS (2002, 2007, 2012 and 2017). For the three revisions covering 2002 until 2016, the codes were unaffected by the HS revisions. In 2017, four codes were affected by changes.⁵⁸ The four affected codes were split into additional HS codes,⁵⁹ on the basis of proposals from the Food and Agriculture Organization of the United Nations (FAO) to enhance data on trade and use of agricultural machinery.

188. Two conclusions can be drawn from this analysis: (i) the HS codes contained in the MAC Protocol Annexes will only rarely be affected by changes to the HS, and (ii) the Depositary and Supervisory Authority of the MAC Protocol could participate in the negotiation of future HS revisions to try to limit any changes that would have an adverse effect on the MAC Protocol. Despite the anticipated limited impact HS revisions will have on the MAC Protocol Annexes, the treaty must have a clear and balanced amendment mechanism that is both acceptable to Contracting States and sufficiently adaptable to reflect changes to the HS.

Secretariat Proposal

189. CGE2 requested that the Secretariat provide a drafting proposal that reflected the following policy points:

- (i) The amendment article(s) need to balance the ability of Contracting States to control the scope of the treaty with a flexible mechanism for amending the Annexes to the Protocol in relation to changes made to the Harmonised System itself.
- (ii) The Protocol should contain different amendment mechanisms, adapted to the nature of the proposed change.
- (iii) The Protocol should ensure that the Annexes to the Protocol contain a precise list of codes, to ensure the scope of the Protocol is clear and predictable.

190. In order to identify a broadly acceptable solution, the Secretariat has undertaken research on the different amendment processes and mechanisms used in existing international treaties, to ensure that the articles proposed in this document are firmly grounded in existing treaty practice.⁶⁰

Distinction between "amendments" and "technical adjustments": the dual approach

191. The Secretariat proposes that the MAC Protocol utilise a dual approach to amending its text. Under this approach, a distinction is made between (i) amendments to the articles of the Protocol and amendments to the HS codes in the Annexes *unrelated* to HS revisions (Article XXXIII) and (ii) "technical adjustments" to the Annexes required by HS revisions (Article XXXIV). It is common practice for treaties to provide "multiple amendment procedures for different parts of the treaty,

⁵⁸ (i) 842481: Mechanical appliances (whether or not hand-operated) for projecting, dispersing, or spraying liquids or powders; fire extinguishers, whether or not charged; spray guns and similar appliances; steam or sand blasting machines and similar jet projecting machines – Other appliances -- Agricultural or Horticultural (ii) 843230: Agricultural, horticultural or forestry machinery for soil preparation or cultivation; lawn or sports-ground rollers - Seeders, planters and transplanters (iii) 843240: Agricultural, horticultural or forestry machinery for soil preparation or cultivation; lawn or sports-ground rollers – Manure Spreaders and fertilizer distributors (iv) 870190: Tractors (other than tractors of heading 8709) – Other.

⁵⁹ 842481 was split and replaced by 842482 and 842449, 843230 was split and replaced by 843231 and 843239, 843240 was split and replaced by 843241 and 843242, and 870190 was split into five separate codes and replaced by 870191, 870192, 870193, 870194 and 870195. For further information, see UNIDROIT 2017 – Study 72K - CGE2 – Doc. 6, available <https://www.unidroit.org/english/documents/2017/study72k/cge02/s-72k-cge02-06-e.pdf>.

⁶⁰ A summary of amendment mechanisms used in a range of existing international treaties is available in Appendix VIII of the Legal Analysis.

permitting the treaty to strike a more finely tuned balance between sovereignty protection, stability and dynamism.”⁶¹

192. During the CGE meetings, negotiating states were supportive of the MAC Protocol adopting a dual approach to amendment. However, in the current draft MAC Protocol, both approaches are contained in different paragraphs of the same article (Article XXXIII), which blurs the different processes and led to confusion during negotiations. The rationale behind having two separate amendment articles is to make a clear distinction between substantive amendments to the Protocol and its Annexes made at the behest of Contracting States, and technical adjustments to keep the MAC Protocol aligned with the HS, following a revision.

193. Broadly speaking, Article XXXIII adopts the traditional treaty amendment process, whereas Article XXXIV provides a more streamlined approach to technical amendments while still giving Contracting States an appropriate level of control over the process.

194. The Secretariat invites stakeholders to review the proposed amendment articles. An explanation of the proposed article and a flow chart illustrating its operation are below.

Article XXXIII – Review conferences, amendments and related matters

1. *The Depositary, in consultation with the Supervisory Authority, shall prepare reports yearly, or at such other time as the circumstances may require, for the States Parties as to the manner in which the international regime established in the Convention as amended by the Protocol has operated in practice. In preparing such reports, the Depositary shall take into account the reports of the Supervisory Authority concerning the functioning of the international registration system.*
2. *At the request of not less than twenty-five per cent of the States Parties, Review Conferences of the States Parties shall be convened from time to time by the Depositary, in consultation with the Supervisory Authority, to consider:*
 - (a) *the practical operation of the Convention as amended by this Protocol and its effectiveness in facilitating the asset-based financing and leasing of the objects covered by its terms;*
 - (b) *the judicial interpretation given to, and the application made of the terms of this Protocol and the regulations;*
 - (c) *the functioning of the international registration system, the performance of the Registrar and its oversight by the Supervisory Authority, taking into account the reports of the Supervisory Authority;*
 - (d) *whether any modifications to this Protocol or the arrangements relating to the International Registry are desirable; and*
 - (e) *whether to add Harmonized System codes to one or more Annexes, or to remove Harmonized System codes from one or more Annexes.*
3. *Any amendment to this Protocol other than technical adjustments to the Annexes pursuant to Article XXXIV shall be approved by at least a two-thirds majority of States Parties participating in the Conference referred to in the preceding paragraph and shall then enter into force in respect of States Parties which have ratified, accepted or approved such amendment when it has been ratified, accepted or approved by five States Parties in accordance with the provisions of Article XXV relating to its entry into force.*
4. *Any amendment to the Annexes shall not affect rights and interests arising prior to the date the amendment becomes effective or applicable.*

⁶¹ Jutta Brunnée, ‘Treaty Amendments’, in Duncan B. Hollis (ed), *The Oxford Guide to Treaties* (OUP 2012) 352.

Article XXXIV – Technical adjustments to the Annexes

1. Upon the adoption of a revision of the Harmonized System, the Depositary shall consult the World Customs Organization and Supervisory Authority in relation to any HS codes listed in the Annexes that might have been affected by the revision.
2. The Depositary shall inform all Contracting States notifying them of any HS codes in the Annexes affected by the revision and propose technical adjustments to the HS codes in the Annexes that ensure the Annexes remain aligned with the Harmonized System. Technical adjustments proposed by the Depositary shall attempt to minimise changes to the application of the Protocol to mining, agricultural and construction equipment resulting from the revision of the Harmonized System.
3. Technical adjustments to the Annexes proposed by the Depositary under paragraph 2 are deemed to have been adopted by Contracting States unless any Contracting State objects to a technical adjustment within twelve months of being notified.
4. Where one or more Contracting States object to a technical adjustment within twelve months of being notified, the Depositary shall convene a meeting of Contracting States to consider technical adjustments to the HS codes in the Annexes to which objection has been made. In considering such technical adjustments to the Annexes, participating Contracting States shall make every effort to reach agreement by consensus. If all efforts at consensus have been exhausted, and no agreement reached, decisions shall be adopted by a two-thirds majority vote of the Contracting States present and voting. Decisions by the meeting of Contracting States shall be binding on all Contracting States.
5. Where a proposed technical adjustment fails to be adopted by a meeting of Contracting States under paragraph 4, the HS code affected by the proposed technical adjustment shall be removed from the Annexes in order to retain consistency with the Harmonized System.
6. The Depositary shall inform Contracting States of all changes to the MAC Protocol Annexes under paragraphs 3, 4 and 5. Unless otherwise provided, such changes shall enter into force six months from the date of the circulation of the communication by the Depositary.
7. Any changes to the Annexes under paragraphs 3, 4 and 5 shall not affect rights and interests arising prior to the date the changes becomes effective or applicable.

Analysis

Article XXXIII

195. Article XXXIII is almost identical to the amendment articles in the Cape Town Convention and its three existing protocols.⁶² It reflects traditional amendment mechanisms in the majority of treaties. Under this approach, amendments to the Protocol are adopted by Contracting States at Review Conferences and only enter into force once a certain number of states have ratified, accepted or approved the amendment. The amendment does not enter into force for any particular Contracting State unless it has ratified, accepted or approved the amendment. This continues to be an appropriate mechanism for amending the articles of the Protocol itself.

196. Paragraph 2 (e) provides that the traditional treaty amendment mechanism will also apply to the addition or removal of HS codes from the MAC Protocol Annexes, *unrelated to HS revisions*. This subparagraph is designed to act as the mechanism for the substantive expansion or reduction in the scope of the Protocol. For example, if in 2032 a State proposes that an additional HS code covering a certain type of mining equipment be added to Annex 1, Contracting States will only be able to add the HS code to Annex 1 through a Review Conference. As this type of change would be a substantive expansion of the MAC Protocol, unrelated to any of the HS codes already listed in the Annexes, it appears appropriate for this amendment to require both approval by two-thirds of the

⁶² Cape Town Convention Article 61, Aircraft Protocol Article XXXVI, Luxembourg Rail Protocol Article XXXIII and the Space Protocol Article XLVII.

Review Conference and then be individually ratified, accepted or approved by each Contracting State.⁶³

197. Paragraph 4 has also been inserted to clarify that the removal of an HS code from the Annexes shall not affect pre-existing rights and interests. This would likely already be the result under the transitional provisions under Article 60 of the Cape Town Convention and Article XXVI of the draft MAC Protocol. However, it is suggested that it be reaffirmed in relation to the Annexes to make perfectly clear that pre-existing rights in MAC equipment won't be affected by the subsequent removal of the relevant HS code from the MAC Protocol Annexes.

Article XXXIV

198. Article XXXIV sets out the process for making necessary changes to the HS codes in the Annexes ("technical adjustments") as a consequence of a periodic revision to the HS.

199. Article XXXIV provides a "hybrid" amendment mechanism for technical adjustments to the Annexes. This "hybrid mechanism" incorporates both a tacit amendment procedure and a secondary meeting of Contracting States mechanism should the tacit amendment procedure fail. The tacit amendment procedure is designed to provide an efficient system for technical adjustments to the Annexes, balanced with the secondary meeting mechanism to give Contracting States sufficient control over the process.

200. The adjustment mechanism in Article XXXIV is closely modelled on the amendment procedure⁶⁴ of the *Convention on the Prohibition of the Development, Production, Stockpiling and use of Chemical Weapons and on their Destruction* (hereafter the "CWC"),⁶⁵ a treaty adopted in 1993 with 193 state parties. While the purpose and the subject matter of the CWC are extremely different to the MAC Protocol, the amendment process is analogous to the extent that the material included in its scope of application is determined by technical Annexes. The CWC allows amendments to the Schedule of Chemicals through a hybrid mechanism that utilises both a tacit amendment procedure and a secondary meeting mechanism. All 193 States Parties to the CWC are bound by changes to the Schedule of Chemicals approved either tacitly or by a two-thirds binding majority vote.

201. Paragraph 1 of Article XXXIV establishes that the technical adjustment process is triggered by a revision of the HS.⁶⁶ "Adoption of a revision to the HS" refers to the time at which the WCO Council formally adopts a revision to the HS. This is typically two years before the revision comes into force (for example, the 2022 revision will be formally adopted by the WCO Council in late 2019). Technical adjustments to the MAC Protocol Annexes should enter into force at the same time as the HS revision enters into force. On the basis of the established WCO timetable, this will allow two years for the Article XXXIV process to be completed.

202. Paragraph 1 further requires the Depositary to consult both the World Customs Organization and the Supervisory Authority in establishing whether the MAC Protocol Annexes have been affected by the HS revision. The purpose of these consultations is to (i) verify whether the MAC Protocol

⁶³ Most States informally consulted in relation to the proposed amendments mechanism were supportive of the substantive changes to the Annexes unrelated to an HS revision being subject to the proposed Article XXXIII process, although one State did suggest that the more flexible Article XXXIV process would be preferred.

⁶⁴ Further information on the CWC is contained in Appendix VIII of this Legal Analysis.

⁶⁵ https://www.opcw.org/sites/default/files/documents/CWC/CWC_en.pdf.

⁶⁶ One State informally consulted in relation to the proposed amendments mechanism suggested that the technical adjustment process should have an even more streamlined approach for purely cosmetic changes to the HS codes listed in the MAC Protocol Annexes resulting from an HS revision. Under the more streamlined approach, cosmetic adjustments with no legal effect would not require the Depositary to seek approval from Contracting States but would be required to notify them of the cosmetic adjustments and when the adjustments would enter into force.

Annexes have been affected by an HS revision, and (ii) where they have been affected, receive advice on the necessary adjustments. The WCO publishes “correlation tables” illustrating how HS revisions have affected certain HS codes which will assist this process.

203. *Proposal of technical adjustments:* Paragraph 2 provides that the Depositary must inform all Contracting States if HS codes in the MAC Protocol Annexes have been affected by an HS revision. Additionally, Paragraph 2 requires the Depositary to propose technical adjustments that (i) ensure that the Annexes remain aligned with the HS while also (ii) minimising changes in the scope of the MAC Protocol. The first policy goal of ensuring complete consistency between the HS and the MAC Protocol Annexes has priority over the second. However, the second policy goal of minimising changes to the scope is an important limitation that ensures that Article XXXIV cannot be used to unduly change the scope of the MAC Protocol beyond what is strictly required due to an HS revision.

204. *Tacit approval process:* Paragraph 3 provides the first phase of the hybrid amendment mechanism: the tacit approval process. Tacit approval mechanisms have “become a common mode of international-standard setting”.⁶⁷ Generally they are used to amend Annexes to treaties, rather than the substantive articles of treaties. They are commonly used in treaties prepared by the International Maritime Organization, such as the *International Convention for the Prevention of Pollution from Ships* (hereafter “MARPOL”) and the *International Convention for the Safety of Life at Sea* (hereafter “SOLAS”), however they are also used in environmental treaties. Both the CWC and the *Comprehensive Nuclear Test Ban Treaty* also utilise tacit amendment processes as part of a hybrid mechanism.⁶⁸

205. *Objection period:* Paragraph 3 provides 12 months for Contracting States to object to a technical adjustment proposed by the Depositary. The period during which a Contracting State can make an objection varies from treaty to treaty. For instance, the MARPOL Convention prescribes a minimum period of ten months for objections to be made,⁶⁹ whereas the SOLAS Convention allows for an amendment procedure that requires a minimum period of six months.⁷⁰ Other treaties do not provide a specific timeframe and instead refer to a “specified period” for objections.⁷¹ The 12 months proposed for Article XXXIV of the MAC Protocol is to ensure Contracting States have sufficient time to consider the proposed technical adjustments in detail and consult relevant domestic stakeholders, such as tariff and trade experts with experience in the operation of the HS.

206. *Objection threshold:* Paragraph 4 provides that the threshold for the failure of the tacit amendment procedure is “one or more” Contracting States. This extremely low threshold is an additional mechanism to ensure that Contracting States that have concerns about a proposed technical adjustment can discuss their concerns at a meeting of Contracting States. Other treaties occasionally require higher thresholds of opposing states (often one-third of States Parties)⁷² to defeat a tacit amendment. However, a higher threshold might be inappropriate for the MAC Protocol, as all Contracting States will be bound by technical adjustments.⁷³

⁶⁷ Doris Köning, ‘Tacit Consent/Opting Out Procedure’, *Max Planck Encyclopedia of Public International Law IX* (2012) 730-731.

⁶⁸ *Comprehensive Nuclear Test Ban Treaty*, Article VII.

⁶⁹ Article 16(2)(f)(iii).

⁷⁰ See ‘*International Convention for the Safety of Life at Sea (SOLAS), 1974*’, available at <www.imo.org>.

⁷¹ *International Convention on standards of training, certification and watchkeeping for seafarers*, article XII(1)(a)(vii) <https://treaties.un.org/doc/Publication/UNTS/Volume%201361/volume-1361-I-23001-English.pdf>.

⁷² *International Convention on standards of training, certification and watchkeeping for seafarers*, article XII(1)(a)(vii); *SOLAS* article VIII(b)(vi)(2).

⁷³ One State informally consulted in relation to the proposed amendments mechanism suggested that a higher threshold requiring more than one State to oppose the proposed adjustment in order for the tacit approval process to fail. It was also suggested that perhaps an objecting State should be required to give reasons for their objecting to the proposal.

207. *Binding meeting of Contracting States process:* Paragraph 4 provides that on the failure of the tacit amendment procedure on the basis of the objection of one or more Contracting States, the Depositary shall convene a meeting of Contracting States to consider any technical adjustments to which objections were made. The meeting of States is required to try to achieve consensus in relation to the proposed adjustments. However, if consensus cannot be achieved, paragraph 4 requires a two-thirds majority of participating Contracting States to approve the proposed adjustment. The process in paragraph 4 is modelled directly on the CWC. However, there are numerous other examples of binding majority consent mechanisms in existing treaties. *The Cartagena Protocol on Biosafety to the Convention on Biological Diversity* (hereafter the "Biosafety Protocol") adopted in 2000 with 171 States Parties also allows a meeting of the parties to adopt binding two-thirds majority decisions in excluding certain types of living modified organisms from the scope of the Protocol.⁷⁴ Similarly, the *Protocol Relating to the Madrid Agreement Concerning the International Registration of Marks* (hereafter the "Madrid Protocol") and the *Convention on Facilitation of International Maritime Traffic* (hereafter the "FAL Convention") both also allow for certain technical amendments to be made through binding majority consent processes.

208. In a practical sense, the meeting of Contracting States will operate in the same way as a Review Conference would operate under Article XXXIII(3), as both meetings require a two-thirds majority to approve changes. However, the important distinction is that the Review Conference procedure under Article XXXIII(3) is only binding on States Parties that ratify, accede or approve the proposed amendment, whereas the meeting of Contracting States under Article XXXIV(4) first requires an attempt at consensus to approve technical adjustments and then ultimately relies on a two-thirds majority decision that will bind all Contracting States.

209. *Failure of a technical adjustment:* As explained above, technical adjustments are only required for HS codes in the MAC Protocol Annexes that no longer exist in the HS due to a revision. As such, even where Contracting States reject a technical adjustment, retaining the obsolete HS code in the MAC Protocol Annexes would breach the consistency of the Protocol with the HS. To address this issue, Paragraph 5 provides that when a proposed technical adjustment fails to receive two-thirds approval at a meeting of Contracting States, the obsolete HS code shall be removed from the Annexes, to ensure that the MAC Protocol remains aligned with the HS.

210. The importance of paragraph 5 can be illustrated through an example. HS code 843031 listed in Annex 1 of the draft MAC Protocol covers rock cutting and tunnelling machinery. In 13 years, under the 2032 HS revision, HS code 843031 could be subdivided into two separate HS codes: 843038 covering rock cutting equipment used in small mining projects and 843039 covering rock cutting equipment used for boring large holes. On consultation with the WCO and the Supervisory Authority, in compliance with its obligation to minimise changes in the scope of the MAC Protocol, the Depositary could recommend that two technical adjustments be made to the MAC Protocol to replace code 843031 with the two new codes 843038 and 843039. However, a number of Contracting States oppose HS code 843038 being included, on the basis that it covers predominantly low value, un-serialised equipment. At a meeting of Contracting States under paragraph 4, Contracting States oppose 843038, and it fails to reach the two-thirds majority required for approval, whereas 843039 is approved. Under paragraph 5, the original code 843031 would be removed from the Annexes to ensure it remains aligned with the most recent version of the HS. This would be the case even if both proposed technical adjustments failed. Without paragraph 5, 843031 could remain listed in the MAC

⁷⁴ The main purpose of the Biosafety Protocol is to provide for an advance informed agreement procedure regarding the transboundary movement of living modified organisms. Article 7(4) allows for the Conference of Parties to identify certain living modified organisms that will not be subject to advance informed agreement procedure. According to the Article 29(5), the rules of procedure of the Conference of the Parties are applicable to the decisions adopted by the Conference of the Parties. Based on rule 40(1), decisions on matters of substance may be adopted by consensus or, as a last resort, taken by a two-thirds majority vote of the Parties present and voting. Accordingly, under the Biosafety Protocol, a State Party can still be bound by an amendment even without its consent.

Protocol Annexes despite it no longer being part of the HS, creating confusion and uncertainty for parties attempting to utilise the Protocol to finance MAC equipment.

211. *Entry into force of changes:* Paragraph 6 requires the Depositary to inform Contracting States of all changes resulting from the technical adjustments process. The term “changes” encompasses both successful technical adjustments under paragraphs 3 and 4 as well as the removal of obsolete HS codes after a failed technical adjustment under paragraph 5. Unless otherwise provided, such changes enter into force six months after the Depositary informs Contracting States of the changes. The term “unless otherwise provided” allows the Depositary to vary the date of entry into force to align it with the date of entry into force of the HS revision, to ensure that the revisions to the MAC Protocol Annexes don’t enter into force before the new version of the HS enters into force.⁷⁵

212. As consistent with Paragraph 4 of Article XXXIII, Paragraph 7 of Article XXXIV has been inserted to clarify that any changes to the Annexes under paragraphs 3, 4 and 5 shall not affect pre-existing rights and interests. This would likely already be the result under the transitional provisions under Article 60 of the Cape Town Convention and Article XXVI of the MAC Protocol. However, it is suggested that it be reaffirmed in relation to the Annexes to make perfectly clear that pre-existing rights in MAC equipment won’t be affected by any changes to the MAC Protocol Annexes made pursuant to Article XXXIV.

213. *States Parties versus Contracting States:* Under Article 2(1) of the *Vienna Convention on the Law of Treaties*, “State party” refers to a State that has consented to be bound by a Convention and for which that Convention *is* in force whereas “Contracting State” refers to a State which has consented to be bound by a Convention, whether or not that Convention has entered into force. As consistent with the amendment Articles in the Cape Town Convention and existing Protocols, Article XXXIII refers to States Parties, as amendments to the Protocol cannot be made until it has entered into force. This is distinct from Article XXXIV which refers to Contracting States. This is because it is possible that before the MAC Protocol has entered into force an HS revision will occur that necessitates technical adjustments to the Protocol. On this basis, Article XXXIV allows technical adjustments to be considered by Contracting States rather than States Parties.

214. *No opt-out:* Article XXXIV does not provide for an opt-out of the technical adjustment process, even where a Contracting State opposes a technical adjustment. There are two reasons that this approach is proposed. Most importantly, allowing Contracting States an opt-out would mean that the MAC Protocol Annexes might no longer be aligned with the HS in States that exercised an opt-out. As explained throughout this paper, such an outcome would have several undesirable effects. Secondly, allowing Contracting States an opt-out would also fracture the application of the MAC Protocol in different states (i.e. the MAC Protocol Annexes would not uniformly apply to the same equipment in each Contracting State).⁷⁶

215. During the CGE meetings, a small number of participating States advocated for Contracting States having an opt-out from technical adjustments process on the basis that a binding majority consent mechanism without an opt-out would raise constitutional issues for them. To address this

⁷⁵ One State informally consulted in relation to the proposed amendments mechanism suggested that this discretion might be too broad, and would allow the Depositary to bring forward the entry into force of technical adjustments to the MAC Protocol Annexes to period shorter than six months. It was suggested that this would cause problems for Contracting States, and that the Depositary’s discretion should be limited in prevent entry into force ever occurring before six months after approval of the technical adjustments.

⁷⁶ Most States informally consulted in relation to the proposed amendments mechanism were supportive of not allowing Contracting States to opt-out to technical adjustments to the MAC Protocol Annexes approved under the proposed Article XXXIV process, due to the concern that allowing an opt-out would fragment the application of the treaty. However, one State that was consulted suggested that an opt-out might still be required for States that have challenges in agreeing to tacit treaty amendment processes under domestic law. The State further suggested that the opt-out should be designed so that it would only be utilised in a limited fashion.

concern, the Secretariat has ensured that the process in Article XXXIV closely mirrors the process set out in Articles VIII and XV of the CWC. By adopting an adjustment process from a treaty that has been universally implemented, it is hoped that the process proposed in Article XXXIV receives support from negotiating states and avoids any constitutional issues.

Feedback from stakeholders

216. The Secretariat informally consulted a small group of Government treaty experts from approximately 10 States in relation to the proposed Articles XXXIII and XXXIV. Feedback on the proposed articles was very positive, with strong support for the dual approach of differentiating between formal amendments to the Articles of the Protocol under Article XXXIII and technical revisions to the MAC Protocol Annexes under Article XXXIV. States also expressed support for the hybrid mechanism incorporating both a tacit approval process and a meeting of Contracting States process, on the basis that it was justified by the need to ensure the MAC Protocol Annexes remain aligned with the HS and reflects established treaty practice. Some States made suggestions in relation to specific aspects of the Secretariat's proposed amendment mechanisms, which are noted in the footnotes in the above analysis. The WCO did not express an opinion on the particular mechanisms proposed, however it did advise that the amendment process for the MAC Protocol should ensure that the HS codes listed in the MAC Protocol Annexes remain consistent with the HS currently in force.

Y. Supervisory Authority

217. Under the Cape Town Convention system, the Supervisory Authority (SA) has the following key responsibilities:

- Provide for the establishment of the International Registry
- Appoint and supervise the Registrar
- Make or approve regulations for the operation of the International Registry
- Set fees and the amount of insurance or financial guarantee to be procured by the Registrar against its liability under the Convention
- Perform other activities set out in Article 17 of the Cape Town Convention, including periodic reports to Contracting States on the discharge of its obligations under the Convention and Protocol.

218. The SA is concerned solely with the International Registry. It has no responsibility for interpretation of the Protocol, its implementation in matters not pertaining to the Registry or any other functions or activities not related to the Registry. Similarly, the SA is not empowered to adjudicate or otherwise engage in a particular registration, nor does it give instructions to the Registrar to change any data relating to a particular registration.

219. Article XIV of the draft MAC Protocol governs the creation and functioning of the SA. Article XIV provides that the SA is to be designated at the Diplomatic Conference and that the SA and its employees shall enjoy legal immunity deriving from their status as an international entity.

Candidates for the role of Supervisory Authority

220. In contrast to the approach adopted by the Luxembourg Rail Protocol, the Study Group adopted the position that it was undesirable to attempt to create a new international body to act as SA. As such, it is necessary for an existing international body to be identified to perform the role of SA. However, there is some difficulty in identifying a SA for the MAC Protocol, due to the diverse nature of the three categories of equipment (mining, agricultural and construction).

221. Over the past 5 years, UNIDROIT has explored a number of possibilities in terms of potential Supervisory Authorities. The lead candidate continues to be the International Finance Corporation (IFC), which has participated in the development of the MAC Protocol since 2015. Negotiations are ongoing with the IFC in this regard.

222. An additional possibility would be for UNIDROIT to undertake the role of Supervisory Authority itself. While such an approach would not create any conflicts of interest, it would require parts of the Protocol to be redrafted, to reflect that UNIDROIT would perform both the role of Depositary and Supervisory Authority.